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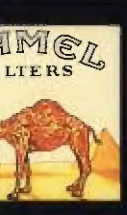
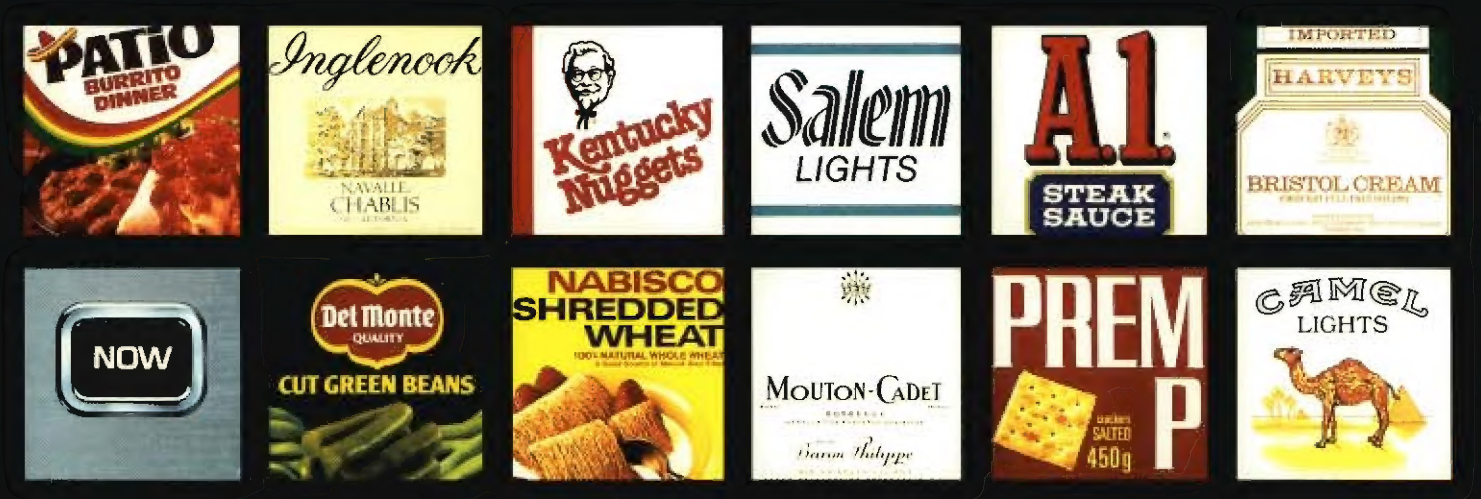
R.J. REYNOLDS INDUSTRIES 1985 ANNUAL REPORT



R.J. Reynolds Industries, Inc. is one of the world's leading consumer products businesses. Through its principal operating subsidiaries, the Corporation has major interests in foods and beverages, tobacco products, quick service restaurants, spirits, wines, beers and packaging products. RJR's products are marketed in virtually every country in the world.

The corporation's worldwide success has been built on its innovative products and services, strengths in manufacturing, marketing, advertising, packaging and distribution, and responsible corporate citizenship.

RJR's World Headquarters is in Winston-Salem, N.C., and its principal operating subsidiaries are Nabisco Brands, Inc., R.J. Reynolds Tobacco Company, R.J. Reynolds Tobacco International, Inc., Kentucky Fried Chicken Corporation, Heublein, Inc., and RJR Archer, Inc.



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R.J. Reynolds Industries, Inc.

Highlights

(Dollars in millions except per share amounts)	1985	1984	Change
For the Years Ended December 31			
Net sales	$16,595	$12,974	+27.9%
Earnings from continuing operations	2,163	1,619	+33.6%
Net earnings from continuing operations	1,001	843	+18.7%
Net earnings from continuing operations per common share[1]	3.60	2.80	+28.6%
Dividends per common share	1.41	1.30	+8.5%
Net earnings from continuing operations as a percentage of net sales	6.0%	6.5%	
Return on average total capital	12.7%	18.6%	
Return on average common stockholders' equity	19.6%	24.8%	
At Year End			
Working capital	$ 1,748	$ 2,864	-39.0%
Book value per common share[1]	19.14	17.33	+10.4%
Number of common shares outstanding (in thousands)	250,566	258,583	-3.0%
Number of stockholders	155,138	114,220	+35.8%
Number of full-time employees	147,513	97,551	+51.2%

[1] The 1985 amounts include the operations of Sunkist Brands, Inc. from July 2, 1985 (see Note 1 to the financial statements). The number of common shares and per share amounts for prior years have been restated to give effect to a two-for-one stock split (see Note 13 to the financial statements).

The merger with Nabisco Brands created an extremely large and diverse, yet strategically focused, international company with an unparalleled portfolio of consumer products and services. R.J. Reynolds Industries now has balanced strength in the highly profitable global tobacco industry and the dynamic worldwide food industry.

Letter to Shareholders

To our fellow shareholders:

In 1985, while again achieving record financial performance, your company, through the merger with Nabisco Brands, Inc., emerged as one of the world's largest and most profitable consumer products companies.

The merger enabled the corporation to address all of our long-range key external development objectives. These objectives included achieving a more balanced portfolio from a profit contribution perspective, protecting and enhancing the corporation's competitive position in the consolidating food and beverage industry, securing new sources of business growth, achieving an expanded international presence and enhancing management depth.

The merger created an extremely large and diverse, yet strategically focused, global company with an unparalleled portfolio of consumer products and services. With Nabisco Brands in the family, R.J. Reynolds Industries now has more than 200 brands in 39 product categories. We now have balanced strength in the highly profitable global tobacco industry and the dynamic worldwide foods industry, with canned and frozen foods, beverages, fresh fruit, quick-service chicken restaurants, spirits and wines, cookies, crackers, nuts and snacks, confectionery products, desserts, margarines and cereals.

Last year's record performance included Nabisco Brands' results from July 2. Net earnings from continuing operations exceeded $1 billion for the first time in RJR's history, up 19 percent over 1984, and earnings per share from continuing operations rose 80 cents to $3.60, a 29 percent increase. Consolidated net sales were $16.6 billion, a 28 percent increase, and earnings from continuing operations reached $2.2 billion, up 34 percent.

Reflecting the company's strong financial performance and our confidence in the future, the Board of Directors increased the quarterly dividend on common stock twice during 1985. In April, the dividend was raised from 85 cents to 87½ cents per share, and at the same time the Board declared a 2½-for-1 common stock split, effective May 17. Following the split, the quarterly dividend became 35 cents, and in November was raised again, to 37 cents per share. The new annual rate is an 8.8 percent increase from the rate in effect at the beginning of the year.

This was the 32nd consecutive year in which the dividend payment has increased, except for the federal control year of 1971. The Board's action raising the dividend twice during 1985 continues our policy of maintaining dividend payout at between 35 percent and 45 percent of earnings. R.J. Reynolds has paid a dividend every year since 1900.

With Nabisco Brands in our portfolio, our non-tobacco sales now exceed tobacco revenues for the first time in our history. If Nabisco Brands' figures were included for the full year 1985, 58 percent of sales would have come from foods and beverages and 42 percent from tobacco. However, tobacco would have contributed 58 percent of earnings from operations, with foods and beverages contributing 42 percent. With its strong profit margins, tobacco will

Constituting the Office of the Chairman are (left to right): Edward A. Horrigan, Jr., vice chairman of the board; J. Tylee Wilson, chairman and chief executive officer; and F. Ross Johnson, president and chief operating officer.

The company's goal is to become the most efficient producer and effective marketer of quality consumer products and services in the world. By doing so, RJR will offer superior value to consumers, and increasing value to its shareholders.

continue to be our number one source of earnings for many years.

The merger places Reynolds Industries at the forefront of U.S. corporations conducting business in the international consumer marketplace. With the addition of Nabisco and its 170 plants in 35 countries, combined 1985 non-U.S. sales of $5.8 billion will move RJR from eighth in total international revenues among U.S. consumer goods companies to the number one ranking. International sales now represent almost 30 percent of our revenue, with nearly two-thirds coming from our food and beverage companies.

The merger also affords the opportunity for Reynolds Industries' operations around the globe to leverage management talent, sales and distribution networks, and technological and marketing capabilities.

We have already taken steps which will help us realize benefits from the merger. On January 1 of this year we combined Del Monte, already a large and successful food company, and Nabisco Brands to create a worldwide food and beverage enterprise. The new organization bears the name Nabisco Brands and will have annual sales of more than $10 billion. We believe the combined enterprise will grow faster and be more profitable than either Del Monte or Nabisco would have on their own.

Consistent with our goal of focusing on consumer products, we streamlined the corporate portfolio with the objective of divesting businesses that did not fit our strategic plans. Service Systems Corporation, an institutional food service unit, was sold to Marriott Corporation in February. Later in the year, R.J. Reynolds Tobacco Company discontinued the sale of its chewing tobacco products and six of its minor smoking tobacco brands. Shortly before the end of the year, we began efforts to divest Skolniks Bagel Bakeries and Dental Care of America.

Near year end the decision was reached to cease operations of R.J. Reynolds Development Corporation. We formed the Development Corporation in 1981 to help assure the company's long-term growth by identifying and evaluating opportunities that might have the potential to become major lines of business. Since 1981, however, we have acquired Heublein Inc., Kentucky Fried Chicken Corporation and Nabisco Brands, providing the corporation with major positions in many business categories. Therefore, we felt we now have ample opportunity to assure the long-term growth of our company by expansion within our existing businesses and no longer needed the Development Corporation.

RJR Archer, Inc., our packaging subsidiary that was the largest unit of the Development Corporation, enjoys an excellent reputation as a manufacturer of high-quality packaging for tobacco and other industries and will remain in the corporate family.

Our goal for the future is to become the most efficient producer and effective marketer of quality consumer products and services in the world. By this means we will provide the consumer superior value while also providing increased value to R.J. Reynolds' shareholders.

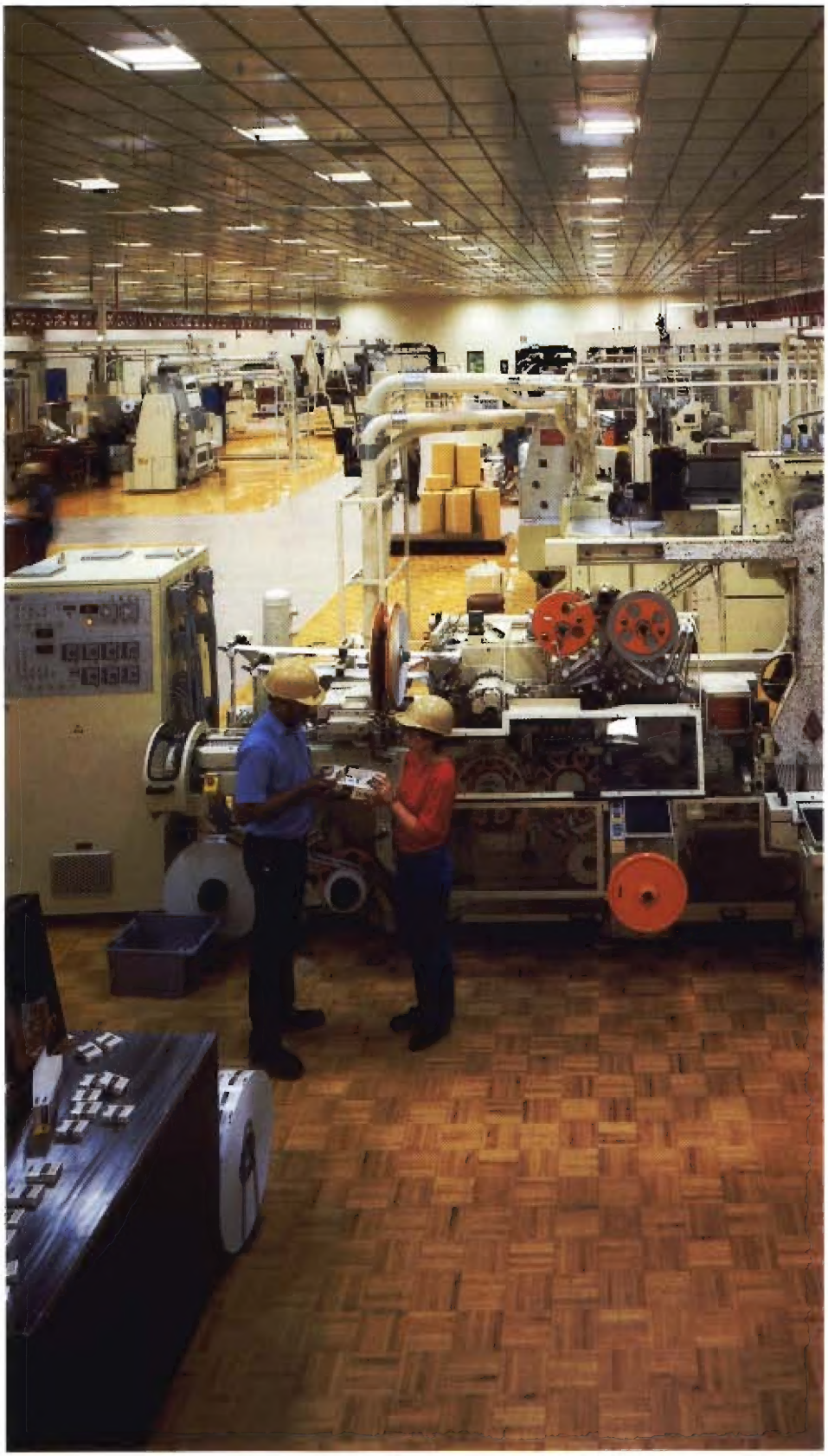
We intend to achieve our goal by effective execution of three major strategies. First is the effective management of resources. Second is the achievement of marketing excellence and innovation. And third is the strengthening of our research and development capability, which we feel is absolutely essential in the

food and tobacco businesses. Toward that end we have recently completed or have under construction more than $100 million in new research and development facilities at Reynolds Tobacco, Nabisco Brands and Kentucky Fried Chicken.

You will find detailed operating reviews of our major businesses beginning on page 8.

We are aware that many investors have been concerned about the widely publicized tobacco product liability suits against R.J. Reynolds Tobacco Company and other industry members. Although the number of such suits pending against Reynolds Tobacco has increased during the year, we are encouraged by the fact that in the only two cases tried during the year the results were wholly in our favor.

In the first case, a Federal District Court judge in Tennessee directed a verdict for Reynolds Tobacco after the plaintiff had presented his case to the jury. In the second, a jury in California found Reynolds Tobacco not liable in a suit brought by the family of a deceased person. Although there have been more than 100 such cases brought against the Tobacco Company over time, none has resulted in settlements or judgments for the plaintiffs. In addition, 319 cross-claim suits filed against Reynolds Tobacco and four other tobacco companies by GAF Corp., an asbestos manufacturer, were dismissed on procedural grounds in California. The dismissal of these suits and the results in the two cases recently tried are consistent with past history

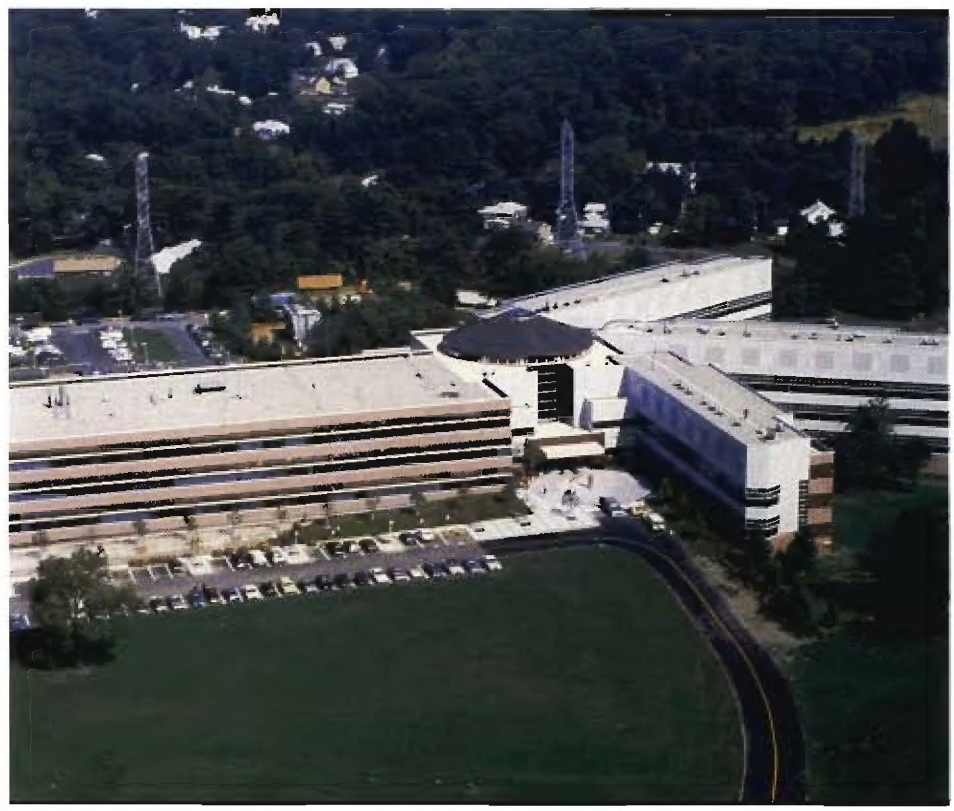


R.J. Reynolds Tobacco Company's 2-million-square-foot cigarette manufacturing plant in Tobaccoville, N.C., is nearing completion. The plant will be fully operational in 1987, and will support Reynolds Tobacco's efforts to become the low-cost supplier of cigarettes to the U.S. market.

The company has invested more than $100 million in three new technical centers as part of its strengthened commitment to research and development, a key strategy for RJR's growth.

Bowman Gray Technical Center, Winston-Salem, N.C.

Harland Sanders Technical Center, Louisville, Ky.



Robert M. Schaeberle Technology Center, East Hanover, N.J.

and further confirm that our position on product liability is strong and defensible.

A number of executive changes were made during the year in RJR's senior corporate management. As part of the Nabisco merger, F. Ross Johnson, vice chairman and chief executive officer of Nabisco Brands, became president and chief operating officer of Reynolds Industries. Edward A. Horrigan, Jr., formerly RJR's president and chief operating officer, became vice chairman of the board. J. Tylee Wilson, RJR chairman and chief executive officer, Johnson and Horrigan make up the newly formed Office of the Chairman of Reynolds Industries.

H.C. Roemer, Jr., senior vice president, corporate secretary and member of the Board, retired effective February 1, 1986. Roemer was succeeded as corporate secretary by James N. Crittenden, who also was elected vice president and deputy general counsel of Reynolds Industries. Crittenden had been vice president, general counsel and secretary of Del Monte.

In the months following the merger, we announced a number of additional management changes. Three corporate staff officers, John W. Dowdle, Harold L. Henderson and Arnold B. Sidman, were elected senior vice presidents of the parent company. Gerard R. Gunzenhauser moved from Del Monte to Reynolds Industries and was elected senior vice president and controller. Two Nabisco Brands officers were elected to RJR corporate positions: Harrison M. Bains, Jr. to vice president and treasurer, and Dr. John A. Maselli to vice president, research and development. Dr. Maselli succeeded Dr. Roy E. Morse, who retired earlier in the year. Marshall B. Bass was promoted to vice president of public affairs from his previous position as vice president of personnel development.

A number of significant executive changes also were made in the operating companies. With Ross Johnson becoming president of the parent company, James O. Welch, Jr., president of Nabisco Brands, became its chief executive officer. Robert M. Schaeberle continues as chairman of Nabisco Brands. As part of the combining of Nabisco Brands and Del Monte, Robert A. Fox, formerly chairman and chief executive officer of Del Monte, and Robert J. Carbonell, formerly president of Nabisco Brands USA, became vice chairmen of the new Nabisco Brands organization. Charles J. Chapman, formerly president and chief operating officer of Del Monte, became executive vice president of Nabisco Brands, Inc. and president of Nabisco Brands USA.

At Heublein, John A. Powers was promoted from president to chairman, continuing as chief executive officer. Robert M. Furek became president and chief operating officer.

The R.J. Reynolds Board of Directors was expanded to 21 members during the year. As a result of the Nabisco Brands merger, Ross Johnson, Bob Schaeberle and Jim Welch joined the Board. The merger also brought two other new members to the Board: Charles E. Hugel, president and chief executive officer of Combustion Engineering, Inc.; and Andrew G. C. Sage II, managing director of Shearson Lehman Brothers, Inc. All five had served on Nabisco Brands' board.

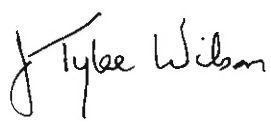
William S. Anderson, chairman of the executive committee of NCR Corporation, returned to the Board in April. Anderson served on our Board from 1977 to 1984 and did not stand for re-election in 1984.

In summary, our plans for 1986 and beyond are very aggressive and will require each operating company to outperform the industry in which it competes. Management is confident, however, that our strategies are sound and the resources are in place to achieve excellent results. The external threats faced by the corporation will continue to be managed to ensure the optimum protection of R.J. Reynolds' shareholders.

With the strong and much appreciated support of our more than 147,000 employees around the world, your company is now poised for perhaps the greatest period of internal growth in its history. We look forward to continued performance improvements in 1986 and to further enhancing the value of your investment.

We most cordially invite you to join us at the company's Annual Meeting, to be held at 2 p.m. Wednesday, April 23, at the Hotel du Pont in Wilmington, Del. We look forward to meeting with you there.

The Office of the Chairman:



J. Tylee Wilson
Chairman and Chief
Executive Officer

F. Ross Johnson
President and Chief
Operating Officer

Edward A. Horrigan, Jr.
Vice Chairman of the Board

Winston-Salem, N.C.
February 14, 1986

TOBACCO

Reynolds Tobacco increased its sales, earnings from operations and share of the U.S. cigarette market in 1985. The company's four best selling brands — Winston, Salem, Camel and Vantage — turned in good performances and continue to contribute to the company's strong position in the industry.

R.J. Reynolds Industries' combined domestic and international tobacco sales increased 2.8 percent to $8.1 billion in 1985, and earnings from operations rose 14 percent to $1.5 billion.

These strong results were particularly notable because they were achieved during a year marked by difficult conditions for the tobacco industry worldwide. Most of the challenges facing the industry in the year — issues of taxation, price supports and product liability suits — were not new. The industry has been successfully dealing with these issues for years, and remains confident in the future of the tobacco industry.

R.J. Reynolds Tobacco Company

R.J. Reynolds Tobacco Company achieved record sales and earnings from operations in 1985. Earnings from operations increased 13 percent on sales that were 3.7 percent higher than in 1984.

Reynolds Tobacco strengthened its marketplace performance in 1985 as its estimated share of the U.S. cigarette market grew at the consumer level. Since 1980, the company has increased its share of market at the consumer level every year except 1983, when the doubling of the federal excise tax on cigarettes depressed industry sales.

The company remains confident that its strategy of offering quality cigarettes in every important market segment will allow it to strengthen its share of the market.

Reynolds Tobacco's four best selling brands, Winston, Salem, Camel and Vantage, continued to perform well in 1985. As four of the country's top 10 brands, they play a key role in maintaining RJR's strong position in the tobacco industry.

A prime contributor to the 1985 market share increase was Doral, the country's first branded cigarette that sells at prices competitive with those of generic brands. Reynolds Tobacco's ability to interpret consumer preferences led it to believe the market would accept a brand priced to compete with generics, and Doral has exceeded the company's expectations. Although Doral receives little advertising support, the brand has attracted a 1.2 percent share of the market, attesting to the continuing viability of the price-conscious segment of the cigarette market.

R.J. Reynolds' other successful product in the value segment is Century, the first brand to offer U.S. smokers 25 cigarettes at about the price of a traditional pack of 20, a concept that has since been imitated by other manufacturers. During 1985, Century Lights Menthol 100s were introduced in major menthol markets across the United States.

Ritz, the first U.S. cigarette associated with a world-famous fashion designer, proved highly successful in its test market introduction in 1985. The brand's packaging and advertising strongly reflect the influence of Yves Saint Laurent, and female smokers have responded very positively to this combination of stylish imagery and a premium quality product.

Winston held its position as R.J. Reynolds Tobacco's best selling brand in 1985, and the second most popular cigarette in the nation.

Winston

By offering quality cigarettes in every important segment of the market, R.J. Reynolds Tobacco Company believes it will continue to outperform the U.S. tobacco industry in the years ahead.

Based on its solid test market performance, Ritz will be introduced nationally in April.

In addition to its emphasis on targeted marketing and product development, R.J. Reynolds Tobacco believes that increased manufacturing efficiencies will play a key role in maintaining its competitiveness in the industry in the years ahead.

Between 1981 and 1990, when the company's facility modernization programs will be completed, the company will have increased its manufacturing productivity almost 60 percent. In addition, lower manufacturing costs as a percentage of sales are expected to enhance the company's profit margins once construction is completed.

The company's 2-million-square-foot Tobaccoville, N.C., manufacturing complex began initial production in January 1986 and is expected to be fully operational in 1987.

The Tobaccoville facility, the world's largest and most modern cigarette manufacturing plant, will support Reynolds Tobacco's objective of becoming the low-cost supplier of cigarettes to the U.S. market.

The expansion and modernization program at the company's Whitaker Park manufacturing facility is about two years ahead of schedule, with completion now targeted for 1988. During the year, Reynolds Tobacco also expanded its cold-storage cigarette facility in Winston-Salem, doubling the company's long-term storage capacity.

In addition, the company has also begun to install the same high-speed cigarette making and packing equipment to be used in Tobaccoville and Whitaker Park in some of its other manufacturing facilities. This equipment, capable of producing cigarettes at twice the speed of the making and packing equipment it replaces, is the most visible part of a technological revolution taking place virtually throughout Reynolds Tobacco's operations.

Computer control of entire manufacturing processes, automated handling of materials and products, and the application of new technology to sales and administrative functions will all play a key role in the company's future. When Reynolds Tobacco's modernization program is completed at the end of this decade, these innovations will give the company a competitive edge in working conditions, administrative efficiency, product quality and low-cost productivity matched by few companies in any industry.

During 1985, Reynolds Tobacco sold 10 of its chewing tobacco brands and discontinued production of its other chewing tobaccos and minor smoking tobacco styles. Chewing tobacco, R.J. Reynolds' first product, accounted for less than 1 percent of current sales.

With its outstanding line of well-targeted cigarette products, and the production efficiencies necessary to achieve improved profitability, R.J. Reynolds Tobacco Company is well-positioned for the years ahead.

R.J. Reynolds Tobacco International, Inc.

R.J. Reynolds Tobacco International outperformed the international tobacco industry, increasing its volume

Salem was the nation's leading menthol brand in 1985, and the third best selling cigarette in the United States. Among new brands, Doral and Century offer high quality to cost-conscious consumers.

R.J. Reynolds Tobacco International outperformed the international tobacco industry in 1985 by increasing volume, earnings from operations and its share of the market outside the United States. The company provides both globally popular brands and brands tailored to regional and local tastes.

by 2.5 percent to a total of about 86.8 billion units in 1985.

Earnings from operations increased more than 12 percent for the year but sales remained constant with 1984 levels, due primarily to unfavorable exchange rates caused by the strong U.S. dollar.

Tobacco International increased its share of the international cigarette market in 1985, with a particularly strong performance in Western Europe.

The company's performance in 1985 is the result of its ability to meet consumer preferences with an array of products in the international marketplace. The company's global brand, Camel, is marketed with a worldwide advertising and promotional program.

Tobacco International also develops and markets a variety of brands tailored to consumer preferences in individual countries, markets and regions of the world. The development of these brand categories gives Tobacco International more flexibility than most of its competitors.

During 1985, Camel was a leader in the accelerating growth in popularity of American-blend cigarettes overseas. The brand increased its share in nine of its top 10 markets. Worldwide volume for the brand increased 7 percent to a total of 26 billion units in the year.

In an effort to broaden its international franchise, Camel was introduced into several new African markets during the year.

One of the most significant agreements reached by Tobacco International in 1985 was the signing of a new 20-year agreement with Tabacalera S.A., the Spanish tobacco monopoly. Camel is now priced on a par with locally produced brands sold by the monopoly, and is considerably less expensive than imported brands.

Camel's consistent worldwide marketing and advertising program continues to spur the brand's global sales increases. The unified imagery of the campaign makes Camel one of only a handful of global consumer product brands — those with universal appeal in nations around the world.

Winston and Salem, Tobacco International's other major brands, continued to increase both share and volume. Salem was the world's fastest growing menthol brand, and among the fastest growing of any type. Salem's growth was particularly strong in the Far East.

Winston's strong performance was especially notable in Spain, and Winston also recorded a strong performance in Puerto Rico.

The company's local brands, tailored to the specific taste preferences of the countries in which they compete, also performed well in 1985, despite difficult economic conditions. Among them were Dorchester in the United Kingdom, Mustang in Brazil and Export "A" in Canada.

R.J. Reynolds Tobacco International's mix of well-known international brands, like Camel, Salem and Winston, and its line of local and national brands developed for specific regions, place the company in a strong position to develop future growth and profitability.

R.J. Reynolds Tobacco International has developed a worldwide advertising and promotional program for Camel cigarettes. Called the "Camel World" campaign, it focuses on the brand's consistent taste and popularity no matter where Camel is sold. Camel's international volume increased 7 percent in 1985 to a total of 26 billion units.

With the addition of Nabisco Brands to the R.J. Reynolds family of food and beverage companies, RJR has an unparalleled supermarket presence. RJR now markets more than 200 brands in 39 product categories. Many of those brands are the leaders in their market segments.

FOOD AND BEVERAGE

R.J. Reynolds Industries' combined domestic and international food and beverage sales for the year increased 66 percent to $8.5 billion, and earnings from operations rose 97 percent to $763 million. The sharp increase in food and beverage sales and earnings from operations largely reflects the inclusion of Nabisco Brands' results from July 2.

As of January 1, 1986, the operations of Del Monte Corporation were combined with Nabisco Brands to form one of the largest and most profitable food and beverage operations in the world. More than 200 leading brands in 39 product categories are now in RJR's greatly expanded portfolio of consumer products.

Kentucky Fried Chicken Corporation performed well during 1985, despite slowing growth in the U.S. quick-service restaurant industry.

Heublein Inc. increased its sales, earnings from operations and market share, significantly outperforming the U.S. spirits and wines industries, both of which suffered declines during the year.

Nabisco Brands, Inc.

For the full year 1985, Nabisco Brands, Inc. achieved a 2 percent gain in sales from continuing operations, despite the negative effects of a strong dollar and moderating increases in food prices. Earnings from continuing operations hit an all-time high, increasing 12 percent over 1984 levels, not including merger-related adjustments.

Many of Nabisco's internal goals are in line with those at other RJR companies, including a commitment to maintaining its low-cost-supplier status in the industries in which it competes. To ensure that, Nabisco has spent more than $1.1 billion on new facilities, equipment and other requirements in the last four years, and plans to spend about $900 million in the next three years.

Nabisco Brands also shares a commitment to research and development with the other RJR companies. Developing new products that meet changing consumer demands in the foods industry is a major focus of Nabisco's annual $50 million research and development program. During 1985, Nabisco dedicated its new 370,000-square-foot Robert M. Schaeberle Technology Center adjacent to its East Hanover, N.J., headquarters.

Nabisco operates through three sectors: Nabisco Brands USA, Nabisco Brands Ltd. of Canada and International Nabisco Brands. Each sector increased earnings from operations during the year. Sixty-six percent of Nabisco's sales were generated in the United States, 11 percent in Canada and 23 percent in other countries in 1985.

Earnings from operations increased 19 percent at Nabisco Brands USA on a sales gain of 3 percent. Several factors contributed to these increases, including reduced raw material costs, the success of new product programs, strong merchandising activities, and the increased efficiency of a more effective organizational structure.

The company maintained its leadership position in both the U.S. cookie and cracker markets due largely to the successful introduction of new products including Oreo Mint Cremes, Blueberry Newtons

Many Nabisco brands are household names, and line extensions based on these traditional favorites are often immediate successes.

Nabisco Brands introduced more than 100 new products and line extensions in 1985. The success of many of these entries, together with the market leadership of many of its established brands, helped Nabisco increase both sales and earnings from operations.

and Cherry Newtons, and a 15-variety line of snack crackers built on the Wheat Thins, Better Cheddars and Great Crisps brands. As a result of this new line, snack cracker volumes increased an unprecedented 21 percent. Nabisco also introduced low-salt versions of Ritz, Triscuits and Wheat Thins crackers.

The extraordinary popularity of the new Planters Honey Roasted nuts introduced early in the year played a key role in generating increases in both Planters volume and market share.

The U.S. candy bar business was strong in 1985, and the Baby Ruth and Butterfinger brands increased their volume 7.5 percent during the year.

Nabisco hot cereals increased their market share in 1985 due to the continuing strength of the Cream of Wheat brand and the successful relaunch of Mix 'n Eat hot cereals. In ready-to-eat cereals, Nabisco Shredded Wheat benefited from increasing consumer interest in nutritious cereals. Encouraged by this trend, the company introduced Nabisco Shredded Wheat 'n Bran cereal in 1985.

Fleischmann's, the number one corn oil margarine, and Blue Bonnet margarine ended the year with combined market shares on the rise, maintaining the company's number one brand position in the market.

Nabisco Brands Ltd. of Canada is a publicly held Canadian company, traded on the Montreal and Toronto stock exchanges. Nabisco Brands, Inc. owns 80 percent of the Canadian company's outstanding shares.

In Canada, Nabisco enjoys leading positions in markets common to the United States as well as in categories unique to the Canadian company, including baking chips, baking powder, pet food, boxed chocolates and wines.

Nabisco Canada's earnings from operations increased 6 percent in 1985 with sales down 3 percent attributable to weakness in the Canadian dollar and to sluggish food markets. The company successfully held its leading position in the biscuit market, largely through gains made by its Christie Brown division, with contributions from traditional cookie brands and several new snack cracker brands.

In addition, Nabisco Canada's cereals, canned cat food, candy bars, food service, yeast and spirits maintained or increased both volume and market share during the year. Profit margins also improved due to organizational streamlining and the closing or sale of four plants.

International Nabisco Brands markets its products in 120 countries and operates 95 manufacturing plants. In 1985, Nabisco International overcame the effects of a strong U.S. dollar to increase sales 3 percent and increase earnings from continuing operations 14 percent, excluding Van Nelle, the company's chocolate, coffee, tea and tobacco business in the Netherlands, which was divested in December 1984.

The United Kingdom, Nabisco's largest international market, was particularly strong in 1985, with double-digit sales gains in cereals and snacks. Nabisco maintained its number two position in the biscuit business, and its premier position in the potato crisp market segment.

In a continuing effort to broaden its worldwide franchise, Nabisco International acquired two companies in 1985: Marbu S.A., a Spanish biscuit company, and Progress Foods in Norway, a leading snack company. Additionally, a joint venture agreement was negotiated in Thailand.

The company also completed the construction of new biscuit bakeries in Italy and Spain.

Major new product introductions around the world in 1985 included

Nabisco biscuits in Ecuador and Brazil, potato chips in Japan, Fibre Plus cereals in Australia, Miniquiche snack crackers in France and Shortcake D'Oro in Italy.

Nabisco's premier brands, outstanding distribution network and far-ranging geographical presence provide excellent opportunities to introduce Del Monte products into new markets. The combined Nabisco Brands and Del Monte organization, with its wealth of marketing expertise and management depth, is positioned to capitalize on its extraordinary supermarket presence and consumer brand loyalty worldwide.

Del Monte Corporation

1985 was the third straight record year for Del Monte Corporation, marked by a 19 percent increase in earnings from operations on sales that were 6.2 percent higher than in 1984.

Del Monte focused its 1985 efforts on new product development and internal reorganization to build profitable volume growth for the future.

Each of Del Monte's business units contributed to the company's strong performance in 1985, primarily by successfully introducing new products and by managing existing product lines more profitably.

In its core businesses, Del Monte increased its share of the U.S. canned vegetable market to 23 percent while maintaining its 35 percent share of the canned fruit market. By using careful pricing strategies and lowering costs, Del Monte was able to outperform an industry oversupplied with vegetables in the second half of the year.

Del Monte introduced two new product lines nationally in 1985. A new twist was added to an old

Nabisco and Del Monte products are sold in 120 countries. Latin America is one of the geographical areas where RJR sees significant growth potential.

By successfully introducing new products and managing existing product lines more profitably, Del Monte Corporation achieved record results for the third consecutive year. Each Del Monte line of business contributed to the company's strong performance in 1985.

product with the launch of dried fruit snacks, including Yogurt Raisins and Dried Mixed Fruit. The new items were successfully positioned as high-energy, nutritious entries in the snack market. And four new Del Monte Blends, pineapple-based fruit drinks, were introduced in 1985.

In frozen foods, reformulated Chun King frozen entrees were launched into test markets. Del Monte frozen dinners, now sold in plastic trays capable of being used in microwave ovens, were placed into broader test markets in 1985, and plans call for introducing the dinners into additional markets in 1986.

Del Monte fresh fruit operations increased earnings from operations over 1984, when an oversupply of bananas kept prices low. Volume and share of the pineapple and banana markets also improved, with 22,000 tons of fresh pineapple being shipped from Del Monte's new Costa Rican plantation.

In addition, modernized banana packaging and transportation systems that deliver better quality and more attractive fruit were implemented during the year.

Del Monte was also active in franchise beverages. Since acquiring Canada Dry and Sunkist soft drinks in 1984, Del Monte has become the fifth largest U.S. soft drink company and one of the four largest internationally.

Each Del Monte soft drink product is the leader in its market segment. In late 1985, Del Monte began a broad introduction of Diet Sunkist Plus, a Sunkist line extension which contains 10 percent real juice, while new Sunkist Natural was launched regionally.

Canada Dry strengthened its leading position in the U.S. and international mixer and ginger ale markets in 1985. The Canada Dry seltzer line was expanded with the introduction of grapefruit and mandarin orange flavors. Sales of Canada Dry seltzer, which now outsells its nearest competitor by a three-to-one margin, grew by 27 percent in 1985.

The repositioning of Hawaiian Punch as a refreshment beverage targeted to young adults continued in 1985, building on the successful image change that began in 1982.

In its international grocery business, Del Monte achieved sales and earnings increases, despite a weak international economic environment. The successful year was primarily attributable to improved volume on vegetables, beverages, pineapple and canned fruits. New products were also introduced in many markets, including Island Blends fruit drinks in the United Kingdom and new blended tropical juices in Canada.

During 1985, Del Monte strengthened its internal organization by forming Del Monte USA, which combined its dry grocery and beverage products group with its frozen and specialty products group. The company also established a franchise beverage division by combining its soft drink businesses. A food service division was formed to take advantage of that growing market.

With its refined internal structure, a renewed commitment to research and new product development, and enhanced marketing strengths, Del Monte will make significant contributions to the success of the combined Nabisco Brands and Del Monte organization.

Del Monte's successful Lite Fruits and No Salt Added Vegetables appeal to consumers who prefer less sugar and salt in their food.

Kentucky Fried Chicken Corporation increased sales and earnings from operations in 1985, and opened 361 new stores around the world. Ninety-two percent of KFC's company-owned stores in the United States have now completed an image enhancement program, as have 67 percent of franchised stores.

Kentucky Fried Chicken Corporation

Kentucky Fried Chicken achieved record sales and earnings from continuing operations in 1985, despite softening sales in the U.S. quick-service restaurant industry and increased competition worldwide.

KFC's worldwide sales increased by 12 percent. Earnings from operations increased 6.3 percent. The KFC per-store sales average reached a record high of $595,000 in U.S. company-owned restaurants and customer counts were up nearly 14 percent. Franchised stores in the United States also performed strongly with a 10 percent increase in average store sales.

Kentucky Fried Chicken opened 361 new company-owned and franchised stores worldwide, bringing the year-end total to 6,396 in 56 countries and further strengthening its position as the third largest quick-service restaurant system and the largest overseas operator.

KFC's performance was especially noteworthy in light of the restaurant industry environment in the United States and the impact of the strongest dollar in history on international operations. Despite these factors, the company's international revenues were up 4 percent.

The quick-service restaurant industry's growth rate in the United States was about 6 percent, down sharply from 1984's double-digit growth. The lower growth rate was due in part to moderating economic growth in general.

The competitive environment was made even more challenging by an increase in the number of chains attracted to the chicken segment and a growing industrywide move to bigger, more attractive facilities.

KFC successfully met these challenges on two fronts. First, the company continued to strengthen its focus on building new, upscale restaurants and remodeling existing units with new, customer-pleasing exterior and interior decor, increased seating, and drive-through service windows.

Called "Colonel's Classics" in honor of KFC's founder, Colonel Harland Sanders, the new upscale restaurants feature elements such as expanded lobbies, flexible seating, self-serve condiment bars, meal service on plates, dining room attendants during peak hours, faster drive-through service systems, and live plants and extensive exterior landscaping. The Colonel's Classic restaurants, which are KFC's new facility standard, have proven effective in increasing customer satisfaction and building eat-in, drive-through, and carry-out business wherever they have opened.

Second, the company balanced its proven back-to-basics programs — to assure delivery of superior product quality and service — with renewed and more aggressive development and innovation in product and marketing programs.

New store development and image enhancement of existing stores also played a vital role in KFC's growth. At year's end, KFC operated 1,209 company stores in the United States, 104 of them opened in 1985, with another 24 under construction. Franchisees were equally aggressive,

Despite challenges from new competitors in the chicken restaurant industry, KFC remains the leader by far. With the introduction of new products, KFC continues to satisfy changing consumer preferences.

We Do Chicken Right.

The national introduction of Kentucky Nuggets was completed in 1985. Consumers have chosen Kentucky Nuggets over competitive products by a two-to-one margin in taste tests.

building 89 new stores to end the year with 3,414 stores in the United States. A total of 92 percent of company-owned stores and 67 percent of the franchised stores in the United States have now completed their image enhancement programs.

The national rollout of Kentucky Nuggets was completed in record time during early 1985, and they now represent nearly 8 percent of sales. Kentucky Nuggets have been instrumental in attracting new customers to KFC, particularly for lunch. The Colonel's 11 herbs and spices and new breading technology developed by KFC helped Kentucky Nuggets defeat competitive products in consumer taste tests.

Development work on a variety of potential new products and services initiated during 1985 will continue to be evaluated during 1986.

Construction of the new Harland Sanders Technical Center ran ahead of schedule during the year and occupancy is planned for May 1986. The six-story, 215,000-square-foot facility, adjacent to KFC's world headquarters in Louisville, Ky., will be a valuable asset in strengthening the company's research and development capabilities. The Technical Center will house development laboratories, test kitchens, computer operations, engineering and worldwide training.

International operations continued to expand during the year, especially in the Pacific area with its many high-potential markets. The Pacific region offers significant expansion opportunities because Western concepts are generally well-received and chicken is a popular staple in the diets of virtually all countries there. KFC has demonstrated great success with its stores in the region, several of which have delivered annual sales volumes in excess of $2 million.

KFC opened 168 new company-owned and franchised international stores in 1985 and entered five countries where Kentucky Fried Chicken had not previously had a presence.

Four stores opened in Korea, and this booming market will have more than 25 KFC units operating when the Olympics are held there in the summer of 1988.

In Taiwan, three new stores are exceeding sales targets with average annual sales in the $1 million to $2 million range. The first store in Hong Kong opened in September. New Kentucky Fried Chicken stores also successfully opened in Ireland, and a joint venture was begun in Venezuela.

Kentucky Fried Chicken's largest overseas business unit — Japan — increased its store base by 14 percent to 540 restaurants by year end.

Zantigo Mexican Restaurants, a unit of KFC, successfully completed a marketing repositioning strategy during 1985. The chain of 79 quick-service Mexican-style restaurants, primarily in the Midwest, opened 19 new units during the year.

With new products in test markets, new improvements in research and training, and a nearly complete image enhancement program, Kentucky Fried Chicken is prepared to continue to profitably outperform its industry.

Kentucky Fried Chicken expanded its international operations during the year, particularly in the high-potential Pacific region. A total of 168 new company-owned and franchised stores opened outside the United States in 1985, five of them in countries where the Colonel's famous chicken had not previously been available.

Heublein Inc.

Heublein increased sales, earnings from operations and market share in a year when the industries in which it competes — spirits and table wines — experienced declines in volumes.

Heublein's sales rose 3.8 percent in 1985 and earnings from operations increased 4.6 percent, aided by gains for Smirnoff Vodka, José Cuervo Tequila, Black Velvet Canadian Whisky and other established spirits, as well as the addition of new brands to the company's product portfolio.

Heublein's worldwide case volume rose slightly, running counter to the spirits industry's estimated 1 percent to 2 percent decline and a 4 percent drop in U.S. table wine consumption. Heublein's spirits business grew despite a 19 percent increase in the federal excise tax on distilled spirits which took effect October 1.

Only a relative handful of the U.S. spirits industry's approximately 12,000 brands sell more than 1 million cases annually and in 1985 Heublein was the marketer of five of them — Smirnoff and Popov vodkas, Black Velvet Canadian Whisky, Arrow Cordials and The Club Cocktails.

Heublein strengthened its brand portfolio with 35 new spirits and wines, including Wild Turkey Bourbon, Finlandia imported vodka, The Famous Grouse Scotch and Mouton-Cadet Bordeaux wines.

Smirnoff reinforced its position as the free world's leading vodka, with record worldwide sales of 12.5 million cases. Smirnoff case sales grew by nearly 1 percent in the United States and almost 4 percent in overseas markets.

Heublein became a formidable participant in the rapidly growing imported vodka category by acquiring U.S. marketing rights to the superpremium Finlandia Vodka, one of the most popular imports. Further enhancing its position as the country's premier vodka marketer, Heublein also introduced Vikin Fjord, a new deluxe vodka from Norway.

Heublein is also a major factor in the vodka category's midprice segment and sales of its Popov and Relska brands grew significantly, with Popov strengthening its position as the country's second most popular vodka behind Smirnoff. The result was that Heublein succeeded in adding to its more than one-third share of the vodka category, the industry's largest.

Other Heublein spirits brands also contributed to the company's growth in a challenging marketing environment. José Cuervo Tequila, for example, maintained its role as one of the industry's fastest growing major brands, with a volume increase of more than 6 percent. Black Velvet was one of only two U.S.-bottled Canadian whiskies reporting increased sales. Another Heublein import from Canada, Yukon Jack Liqueur, grew an impressive 8 percent in sales

Heublein increased its sales, earnings from operations and market share in 1985 and outperformed the U.S. spirits industry. The company's competitive position was further enhanced by the addition of 35 new spirit and wine brands to its product lineup, including Wild Turkey Bourbon, The Famous Grouse Scotch and Mouton-Cadet wines.

Heublein's Smirnoff, the world's most popular vodka, achieved record worldwide sales in 1985. Smirnoff's case sales grew by 1 percent in the United States, and by 4 percent internationally. Heublein enhanced its position as the nation's premier vodka marketer during the year by securing the U.S. rights to imported Finlandia and introducing new Vikin Fjord.

When it assumed management of All Brand Importers in 1985, Heublein became the only major U.S. alcoholic beverage marketer to offer a full line of spirits, wines and imported beers.

volume. Arrow continued as one of the leading domestic cordial brands, adding 12 new varieties of flavored schnapps.

Heublein began an unusually active year in acquisitions by securing the U.S. distribution rights to The Famous Grouse Scotch, Scotland's leading whisky. Through an agreement with the major French beverage firm of Pernod Ricard, Heublein also obtained U.S. sales rights to one of America's most prestigious spirits brands, Wild Turkey Bourbon, as well as Bisquit French Cognac and Pernod Liqueur, one of the world's best selling liqueurs. As part of the agreement, Pernod Ricard will produce and market Heublein's prepared cocktails in Europe, where prepared drinks represent a major growth segment.

A joint venture agreement was also reached with Mitsubishi Corp. of Japan that will enhance the company's presence in that market with improved distribution of Smirnoff vodka, Inglenook wines, Wild Turkey Bourbon and other products.

Heublein's international operations continued to make an important contribution to the company's sales and earnings, bolstered by significant volume gains by Smirnoff vodka in major markets such as the United Kingdom and Canada. Heublein Brazil also continued to be a major contributor to profits, despite the fact that the subsidiary operates in an economy where triple-digit inflation and interest rates are commonplace.

Heublein's prestigious Napa Valley winery, Beaulieu Vineyard, reported gains in case volumes and revenues and continued as one of California's most profitable wineries. Inglenook Vineyards, while reporting sales slightly below the prior year, succeeded in increasing its share of the important California table wine segment of the industry. Inglenook increased its keg wine business in restaurants and taverns by more than 30 percent, and a new wine carafe package was a major success among consumers.

Already the nation's leading marketer of premium imported table wines, with such noted brands as Lancers from Portugal and Bouchard Père & Fils Burgundies, Heublein improved its share of this burgeoning category by becoming U.S. sales agent for the wines of Mouton Rothschild, including Mouton-Cadet Bordeaux, Rudolph Muller German wines, and Regaleali and Monsanto wines of Italy. Long the importer of the best selling Harveys Bristol Cream Sherry, Heublein in 1985 added the highly regarded Cockburn's Ports to its portfolio of prestige brands.

Heublein continued as the premier marketer of prepared drinks with its Heublein and The Club cocktail lines. Long Island Iced Tea, a 30-proof blend of vodka, tequila and other ingredients, was added to The Club line during the year, and quickly became one of the most successful prepared drinks ever marketed by Heublein.

Heublein was an active participant in the growing low-alcohol beverage category with the introduction of T.J. Swann 6 percent alcohol wine coolers. Babycham, an 8.3 percent

alcohol "perry" wine from England, was given wider distribution after successful test marketing in Massachusetts. Another import from England, Harveys Tico Sherry, was introduced in trial markets as a product designed to serve as the base for lower-alcohol mixed drinks.

Late in the year, Heublein became the only major U.S. alcoholic beverage marketer to offer a full line of distilled spirits, wines and imported beers when it was assigned responsibility for All Brand Importers, Inc., Nabisco's premium imported beer business. All Brand imports and markets Moosehead Canadian Beer, Foster's Lager from Australia, Dos Equis Mexican beer, Pilsner Urquell from Czechoslovakia and other brands. The imported segment now represents more than 4 percent of the total U.S. beer market and is expected to grow 8 percent or more a year.

Heublein continues to keep pace with changing consumer demands and tastes in U.S. and overseas markets by taking steps to offer as broad a spectrum of successful, high-margin spirits, wines and beers as possible. By offering quality brands in dynamic and growing product segments, Heublein is confident of outperforming the alcoholic beverage industry as a whole in the years ahead.

Heublein's Beaulieu Vineyard reported higher case volumes and revenues in 1985, and Inglenook Vineyards increased its share of the important California table wine segment of the market. Already the nation's leading marketer of premium imported table wines, Heublein secured the U.S. rights to several additional French, German and Italian wines.

FAMOUS BRANDS FROM RJR

NABISCO BRANDS, INC.

Beverages
Barrelhead Root Beer
Canada Dry Ginger Ale, Collins Mixer, Club Soda, Seltzers and Tonic
Cott Soft Drinks
Del Monte Blends Juice Drinks
Del Monte Juices, Juice Drinks and Nectars
Hawaiian Punch Beverages
No Cal Soft Drinks
Snap-E-Tom Tomato and Chile Cocktail
Sunkist Soft Drinks
Tahitian Treat
Wink

Cookies
Almost Home Cookies
Apple Newtons Fruit Chewy Cookies
Bakers Bonus Cookies
Barnum's Animals Crackers
Biscos Cookies
Blueberry Newtons Fruit Chewy Cookies
Bugs Bunny Graham Cookies
Cameo Creme Sandwich
Cherry Newtons Fruit Chewy Cookies
Chips Ahoy! Chocolate Chip Cookies
Chips 'n More Chocolate Chip Cookies
Cookie Break Vanilla Artificially Flavored Creme Sandwich
Country Style Peanut Butter Cremes
Fig Newtons Fruit Chewy Cookies
Gaiety Fudge Chocolate Sandwich Cookies
HeyDay Caramel Peanut Logs
Ideal Chocolate and Peanut Bars
Lorna Doone Shortbread
Mallomars Chocolate Cakes
Mystic Mint Sandwich Cookies
Nabisco Brown Edge Wafers
Nabisco Chocolate Chip Snaps
Nabisco Chocolate Grahams
Nabisco Chocolate Pinwheels Cakes
Nabisco Chocolate Snaps
Nabisco Devil's Food Cakes
Nabisco Famous Chocolate Wafers
Nabisco Famous Cookie Assortment
Nabisco Fudge Striped Shortbread
Nabisco Granola and Raisin Soft Snacks
Nabisco Imported Danish Cookies
Nabisco Marshmallow Puffs
Nabisco Marshmallow Sandwich
Nabisco Marshmallow Twirls Fudge Cakes
Nabisco Oatmeal and Apple Soft Snacks
Nabisco Oatmeal and Raspberry Soft Snacks
Nabisco Oatmeal Fudge Cookies
Nabisco Old Fashion Ginger Snaps
Nabisco Pecan Shortbread Cookies
Nabisco Pure Chocolate Middles
Super Heroes Cookies
National Arrow-root Biscuit
Nilla Wafers
Nutter Butter
Peanut Butter Sandwich Cookies
Oreo Chocolate Sandwich Cookies
Pantry Molasses Cookies
Party Grahams Cookies
Social Tea Biscuits

Crackers
Better Blue Cheese, Cheddars, Nacho and Swiss Snack Thins
Cheese Nips Crackers
Cheese Tid-Bit Crackers
Chicken In A Biskit Flavored Crackers
Crown Pilot Crackers
Dandy Soup and Oyster Crackers
Dip In A Chip Cheese 'n Chive Snack Crackers
Doo Dads Snacks
Escort Crackers
Great Crisps! Snacks
Holland Rusk
Honey Maid Graham Crackers
Meal Mates Sesame Bread Wafers
Nabisco Bacon Flavored Thins Crackers
Nabisco Cinnamon Treats
Nabisco Cracker Meal
Nabisco Graham Crackers
Nabisco Graham Cracker Crumbs
Nabisco Zwieback
Oysterettes Soup & Oyster Crackers
Premium Crackers
Ritz Crackers
Royal Lunch Milk Crackers
Sea Rounds Crackers
Sociables Crackers
Triscuit Wafers
Twigs Sesame and Cheese Snack Sticks
Uneeda Biscuits
Vegetable Thins Snack Crackers

Waverly Crackers
Wheat Thins Snack Crackers
Wheatsworth Stone Ground Wheat Crackers

Other Biscuit Products
Chipsters Light 'n Crisp Potato Snacks
Comet Cones, Cups and Sugar Cones
Corn Diggers Corn Snacks
Easy Cheese Pasteurized Process Cheese Spreads
Flings Crispy Corn Curls
Mister Salty Pretzels
NAB Packs
Nabisco Cheese 'n Crunch Cheese Flavored Snack
Toastettes Toaster Pastries

Confectionery & Snack Products
Baby Ruth Candy Bar
Beechies Chewing Gum
Beech-Nut Chewing Gum
Bonkers! Fruit Candy
Bubble Yum Bubble Gum
Butterfinger Candy Bar
Care·Free Sugarless Gum
Charleston Chew! Candy Bar
Chuckles Candy
Fruit Stripe Gum
Junior Mints
Life Savers Roll Candy and Lollipops

Merckens Chocolate
Nabisco Bridge Mix
Nabisco Chocolate Covered Peanuts
Nabisco Chocolate Covered Raisins
Nabisco Chocolate Stars
Pearson Specialty Candy
Planters Nuts
Planters Old Fashioned Candy

Planters Peanut Bar
Planters Snacks
Pom Poms Caramels
Sugar Babies Caramels
Sugar Daddy Caramel Pops and Nuggets
Sugar Free Breath Savers Mints

Fresh Fruit
Del Monte Bananas, Papayas, Pineapples

Grocery Products
A.1. Steak Sauce
Blue Bonnet Margarines
Brer Rabbit Molasses and Syrups
Chun King Oriental Foods
College Inn Broths and Heat & Serve Entrees
Cream of Wheat and Cream of Rice Cereals
Davis Baking Powder
Del Monte Canned Vegetables (Asparagus, Beets, Blue Lake Green Beans, Carrots, Corn, Italian Beans, Lima Beans, Mixed Vegetables, No Salt Added Vegetables, Peas, Peas and Carrots, Potatoes, Sauerkraut, Seasoned Peas, Spinach, Wax Beans, Zucchini)
Del Monte Tomato Products (Catsup, Chili Sauce, Italian Stewed Tomatoes, Mexican Stewed Tomatoes, No Salt Added Tomato Products, Peeled Tomatoes, Seafood Cocktail Sauce, Stewed Tomatoes, Tomato Paste, Tomato Sauce, Tomato Wedges)
Del Monte Canned Fruits (Apricots, Cherries, Chunky Mixed Fruit, Figs, Fruit Cocktail, Fruits for Salad, Lite Canned Fruits, Mandarin Oranges, Peaches, Pears, Pineapples, Tropical Fruit Salad)
Del Monte Dried Fruits (Apples, Apricots, Currants, Mixed Dried Fruits, Peaches, Prunes, Raisins, Yogurt Raisins)
Del Monte Fruit Cups
Del Monte Pickles and Pickle Products
Del Monte Pudding Cups
Del Monte Seafood (Salmon and Sardines)
Dromedary Dates, Pimientos, Cake Mixes and Date Nut Roll
Egg Beaters Cholesterol-Free 99% Real Egg Product
Escoffier Sauces
Fleischmann's Consumer Yeast

Fleischmann's Corn Oil
Fleischmann's Margarines
Grey Poupon Dijon Mustards
Milk-Bone Brand Butcher Bones Dog Snacks
Milk-Bone Brand Dog Biscuits
Morton Frozen Foods (Entrees, Dinners, Donuts, Desserts, Muffins, Pies and Pie Shells)
My•T•Fine Puddings and Pie Fillings
Nabisco 100% Bran
Nabisco Shredded Wheat, Toasted Wheat & Raisins, Shredded Wheat 'n Bran
Ortega Mexican Foods (Chiles, Salsas, Taco Shells and Kits, Taco Seasoning Mix)
Patio Mexican Frozen Foods (Entrees, Burritos, Dinners, Tortillas)
Regina Cooking Wines and Wine Vinegars
Royal Gelatins, Puddings and No Bake Desserts
Spoon Size Shredded Wheat
Team Flakes
Vermont Maid Syrup
Wright's Liquid Smoke

Ice Cream and Frozen Confections
Life Savers Flavor Pops
Oreo Cookies 'n Cream Ice Cream (Chocolate, Mint, Vanilla)
Oreo Cookies 'n Cream on a Stick
Oreo Cookies 'n Cream Sandwich

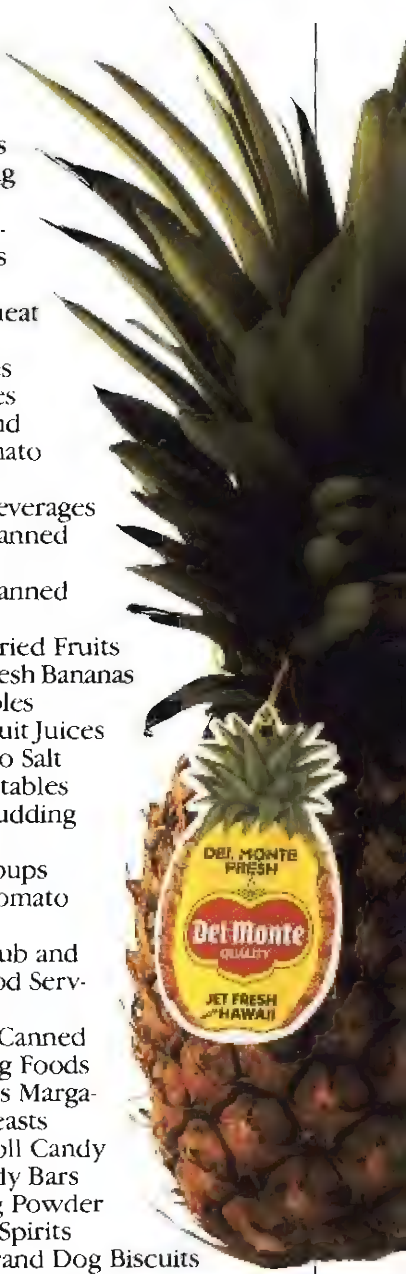
Fleischmann Division
Fleischmann's Baker's Yeast
Fleischmann's Vinegar

Specialty Products
Harry and David Fine Fruits and Foods
Jackson & Perkins Roses and Garden Plants

INTERNATIONAL BRANDS
Canada Dry
Del Monte
Nabisco
Planters
Ritz
Royal
Sunkist

KEY NATIONAL BRANDS

Canada
Aylmer Canned Fruits & Vegetables
Blue Bonnet Margarines
Bubble Yum and Care•Free Gums
'C' Plus
Canada Dry Mixers and Soft Drinks
Calona Wines
Chipits Baking Chips
Christie Cookies, Crackers and Snacks
Cream Of Wheat Cereals
Dad's Cookies
David Cookies
Del Monte and Aylmer Tomato Products
Del Monte Beverages
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Dried Fruits
Del Monte Fresh Bananas and Pineapples
Del Monte Fruit Juices
Del Monte No Salt Added Vegetables
Del Monte Pudding Cups
Del Monte Soups
Del Monte Tomato Products
Dickson's, Club and Melrose Food Service Coffees
Dr. Ballard's Canned and Dry Dog Foods
Fleischmann's Margarines and Yeasts
Life Savers Roll Candy
Lowney Candy Bars
Magic Baking Powder
McGuinness Spirits
Milk-Bone Brand Dog Biscuits and Dog Food
Miss Mew Canned Cat Food
Moirs Boxed Chocolates
Nabisco Cereals
Peek Freans Sweet and Savoury Biscuits
Planters Nuts
Reid Flours
Royal Desserts



Continental Europe
Ardilla Pastas and Cannelloni
Ati Herb Teas
Canada Dry Soft Drinks and Mixers

FAMOUS BRANDS FROM RJR

Catari Pizza Mixes
Chipster Potato Snacks
Cremerinos Biscuits and Wafers
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Catsup
Del Monte Dried Fruits
Del Monte Fresh Bananas, Papayas and Pineapples
Del Monte Fruit Juices and Nectars
Del Monte No Salt Added Vegetables
Del Monte Tomato Products
Feuillete Snack Crackers
Minizza Snack Crackers
Moulin de Jacobert Frozen Pastries
Oro Sweet Biscuits
Oxford Biscuits
Parisienne Pastry Cake
Pepito Chocolate-Covered Sweet Biscuits
Petits Coeurs Sweet Biscuits
Premium Saltine Crackers
Riera-Marsa Dry Baby Foods, Flour Mixes and Instant Mashed Potatoes
Ritz Crackers
Royal Desserts, Gelatins and Cake Mixes
Royal Linfa Soft Drinks

Asia/Pacific
Chicken In A Biskit Flavored Crackers
Chip Star Fabricated Potato Chips
Chips Ahoy! Chocolate Chip Cookies
Corn Diggers Snacks
Minties Candies
Parfait Soft Cake
Picola Crepe Cookies
Planters Nuts and Snack Products
Premium Saltine Crackers
Ritz Crackers
Royal Brand Products
Rum Slice Biscuits
Vita Brits Cereal
Weeties Cereal

Far East
Canada Dry Soft Drinks and Mixers
Del Monte Banana Ketchup
Del Monte Beverages
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Dried Fruits
Del Monte Fresh Bananas and Pineapples
Del Monte Tomato Products
Del Monte Vinegar

Japan
Canada Dry Soft Drinks and Mixers
Del Monte Beverages
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Dried Fruits
Del Monte Fresh Bananas, Papayas and Pineapples
Del Monte Tomato Products

Latin America
Aurora Dessert Products
Bubble Yum Bubble Gum
Cameo Cream Sandwich Cookies
Canada Dry Soft Drinks and Mixers
Del Monte Beverages
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Catsup
Del Monte Dried Fruits
Del Monte Fruit Juices and Nectars
Del Monte Marmalades and Jams
Del Monte Mexican Peppers
Del Monte No Salt Added Vegetables
Del Monte Pickles and Olives
Del Monte Pudding Cups
Del Monte Tomato Products
Fleischmann's Baking Products and Yeast
Gamesa Biscuits and Pasta
Gloria Powdered Milk
Hawaiian Punch Beverages
Life Savers Hard-Roll Candy
Oreo Chocolate Sandwich Cookies
Planters Nuts and Snack Products
Pommys Delicatessen Products
Ritz Crackers
Royal Baking Products
Royal Desserts and Drink Powders
Royalina Drink Powders
Sabueso Dog Biscuits
Sorbetto Sugar Wafers
Sultana Soda Crackers

Middle East
Canada Dry Soft Drinks and Mixers
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Fresh Bananas and Pineapples
Sport Cola

United Kingdom
Bendicks Confectionery
Big D Nuts
Canada Dry Soft Drinks and Mixers
Del Monte Canned Fruits
Del Monte Canned Vegetables
Del Monte Dried Fruits
Del Monte Fruit Juices
Del Monte No Salt Added Vegetables
Del Monte Tomato Products
Granny Smiths Pastry, Bread and Cheese Cake Mixes

Hovis Crackers and Digestive Biscuits
Huntley & Palmer's Biscuits
Jacob's Club Countline
Nabisco Shredded Wheat Cereal
Peek Freans Sweet and Savoury Biscuits
Planters Nuts and Snack Products
Ritz Crackers
Royal Desserts, Gelatins and Cake Mixes
Shreddies Cereal
Smiths Crisps and Snack Products
Tea Time Sweet Biscuits
Trio Countlines, Biscuits, Mallows and Crackers
Walkers Crisps Snack Products

KENTUCKY FRIED CHICKEN CORPORATION

Worldwide
More than 6,000 Kentucky Fried Chicken Restaurants

United States
Zantigo Mexican Restaurants

HEUBLEIN INC.

Spirits
American Creme
Arrow Cordials and Flavored Brandies
Bahia Coffee Liqueur

Bisquit Cognac
Black Velvet Canadian Whisky
Boggs Cranberry Liqueur
Don Q Puerto Rican Rum
Finlandia Vodka
Heublein Cocktails
Irish Mist Liqueur
José Cuervo Tequila
Malcolm Hereford's Cows
Matador Tequila
McMaster's Scotch Whisky
McMaster's Canadian Whisky
Milshire Gin
Patrician Amaretto and Sambuca
Pernod Liqueur
Popov Vodka
Regal Velvet Whisky
Relska Vodka
Smirnoff Vodka
The Club Cocktails
The Famous Grouse Scotch
Vikin Fjord Vodka
Wild Turkey Bourbon and Liqueur
Yukon Jack Canadian Liqueur

California Wines
Beaulieu Vineyard Wines
Citronét Wine Cooler
HMS Frost
Inglenook Navalle Wines
Inglenook-Napa Valley Wines
Jacaré Wines
T.J. Swann Coolers
T.J. Swann Refreshment Wines

Imported Wines
Babycham Perry
Baron Philippe de Rothschild Wines
Black Forest Girl, German Estate Wine
Bouchard Père & Fils Burgundies
Brugo Gattinara, Ghemme and Spanna
Caparzo Brunello di Montalcino
Capezzana Carmignano
Casal Thaulero Montepulciano
Ceretto Barolo and Barbaresco
Château Olivier Bordeaux
Cockburn's Ports
Contratto Asti Spumante and Gavi
Duval French Vermouth
Fassati Montepulciano
Fattoria Monsanto Chiantis
Fazi-Battaglia Verdicchio
Fontana di Papa Italian Wines
Giannozzi Chiantis
Harveys Bristol Cream, Other Sherries and Ports
Henriot French Champagne
Kiku Masamune Sake
Ladoucette Loire Wines
Lancers Portuguese Wines
Livio Felluga Wines
Marc Bredif Vouvray Wines
Mastroberardino Italian Wines
Mouton-Cadet Bourdeaux Wines
Oliver de France Bordeaux AC Wines
Regaleali Sicilian Wines
Rudolf Muller German Wines
Tokaji Aszú Hungarian Dessert Wine
Torresella Italian Wines
Valbon French Table Wines

Imported Beers
Clausthaler German Non-Alcoholic Beer
Dos Equis Mexican Beer
Foster's Lager Australian Beer
Mackeson United Kingdom Stout
Moosehead Canadian Beer
Noche Buena Mexican Beer
Pilsner Urquell Czechoslovakian Beer
Steinhauser German Beer
Superior Mexican Beer
Whitbread United Kingdom Ale

INTERNATIONAL BRANDS
Lancers Portuguese Wines
Popov Vodka
Smirnoff Vodka

KEY NATIONAL BRANDS

Brazil
Bell's Blended Scotch Whisky
Dreher Brandy
Drury's Special Reserve Whisky
Old Eight Whiskey

R.J. REYNOLDS TOBACCO COMPANY

Cigarettes

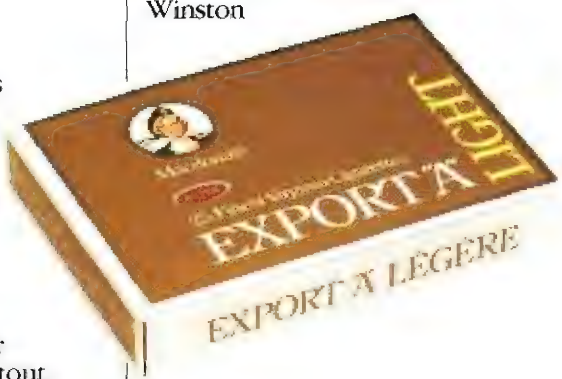
Bright	NOW
Camel	Salem
Century	Sterling
Doral	Vantage
More	Winston

Cigars
Winchester Little Cigars

Smoking Tobaccos
Apple
Carter Hall
Our Advertiser
Prince Albert
Royal Comfort
Top

R.J. REYNOLDS TOBACCO INTERNATIONAL, INC.

INTERNATIONAL BRANDS
Camel
More
Salem
Vantage
Winston



KEY NATIONAL BRANDS

Europe
M
Reyno
Time

United Kingdom
Dorchester

Belgium/Luxembourg
St. Michel

West Germany
Overstolz

Eastern Europe
Gold Coast

Canada
Export "A"
Macdonald Select

Brazil
Century
Chancellor
LS
Mustang
River
Vila Rica

Ecuador
Doral Suave
Full Speed
King

R.J. Reynolds Industries, Inc.

Management Directory

OFFICE OF THE CHAIRMAN

J. Tylee Wilson
Chairman and Chief Executive Officer

F. Ross Johnson
President and Chief Operating Officer

Edward A. Horrigan, Jr.
Vice Chairman of the Board

CORPORATE OFFICERS

Gwain H. Gillespie
Executive Vice President and Chief Financial Officer

Rodney E. Austin
Senior Vice President

John W. Dowdle
Senior Vice President

Gerard R. Gunzenhauser*
Senior Vice President and Controller

Harold L. Henderson
Senior Vice President and General Counsel

Arnold B. Sidman
Senior Vice President

Harrison M. Bains, Jr.
Vice President and Treasurer

James N. Crittenden**
Vice President, Deputy General Counsel and Secretary

Marshall B. Bass
Vice President

Paul J. Bott
Vice President

John A. Maselli
Vice President

Ronald Sustana
Vice President

*Effective January 1, 1986
**Effective February 1, 1986

OPERATING COMPANY MANAGEMENT

Nabisco Brands, Inc.

James O. Welch, Jr.
President and Chief Executive Officer

Robert M. Schaeberle
Chairman of the Board and Chairman, Executive Committee

R.J. Reynolds Tobacco Company

Gerald H. Long
President and Chief Executive Officer

R.J. Reynolds Tobacco International, Inc.

Lester W. Pullen
President and Chief Executive Officer

Kentucky Fried Chicken Corporation

Richard P. Mayer
Chairman and Chief Executive Officer

Heublein Inc.

John A. Powers
Chairman and Chief Executive Officer

Robert M. Furek
President and Chief Operating Officer

RJR Archer, Inc.

George F. Klein
President and Chief Executive Officer

Financial Review

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R.J. Reynolds Industries, Inc.

Selected Five-Year Financial Data

For the Years Ended December 31

(Dollars in Millions Except Per Share Amounts)	1985	1984	1983	1982	1981
Results of Operations					
Net sales	$16,595	$12,974	$12,312	$10,160	$8,699
Earnings from continuing operations	2,163	1,619	1,397	1,222	1,154
Interest and debt expense	356	187	196	186	145
Earnings from continuing operations before provision for income taxes	1,854	1,552	1,288	1,097	1,139
Net earnings from continuing operations	1,001	843	702	584	616
Net earnings (1)	1,001	1,210	881	870	768
Net earnings from continuing operations per common share	3.60	2.80	2.27	2.05	2.24
Net earnings per common share (1)	$ 3.60	$ 4.11	$ 2.90	$ 3.13	$ 2.81
Other Data					
Dividends on common and preferred stocks	$ 448	$ 416	$ 407	$ 340	$ 290
Dividends per common share	1.41	1.30	1.22	1.14	1.00
Dividend payout percentage (2)	39.2%	31.2%	42.1%	36.5%	35.2%
Common Stock price range:					
High	$ 35	$ 29	$ 25⅜	$ 22⅞	$ 21⅛
Low	24¾	21⅛	18	16	16¼
Net earnings from continuing operations as a percentage of net sales	6.0%	6.5%	5.7%	5.7%	7.1%
Number of common shares outstanding at year end (in thousands)	250,566	258,383	283,183	281,491	260,887
Number of stockholders at year end	155,138	114,220	126,889	126,045	110,707
Number of full-time employees of continuing operations at year end	147,513	97,551	94,774	89,689	75,809

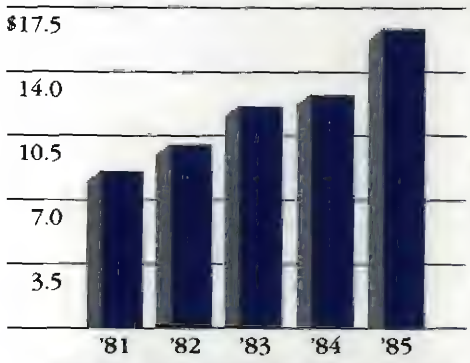
The 1985 amounts include the operations of Nabisco Brands, Inc. from July 2, 1985 (see Note 1 to the Financial Statements). The number of common shares and per share amounts for prior years have been restated to give effect to a two and one-half for one Common Stock split (see Note 13 to the Financial Statements).

(1) The 1984 amounts include a net gain on the sale of the Company's energy operations of $275 million, or 98 cents per share (see Note 16 to the Financial Statements).

(2) Total dividends on Common Stock as a percentage of net earnings applicable to Common Stock. The 1984 dividend payout percentage would be 41 percent excluding the gain on the sale of the energy operations.

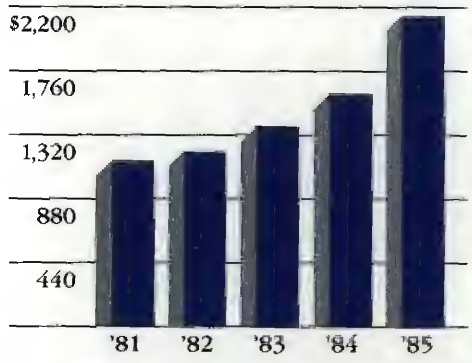
Consolidated Net Sales

(Dollars in Billions)



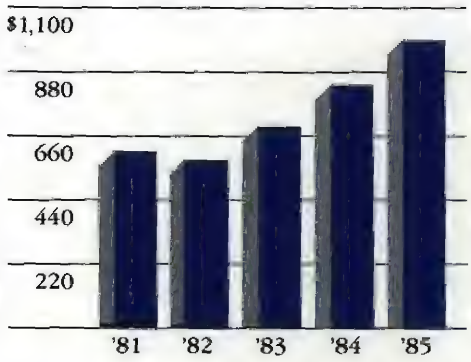
Consolidated Earnings from Continuing Operations

(Dollars in Millions)



Consolidated Net Earnings from Continuing Operations

(Dollars in Millions)



Management's Discussion and Analysis

The Company now classifies its continuing operations into two principal lines of business. Prior years' amounts have been reclassified to conform with the current year presentation.

Results of Continuing Operations

Consolidated

Consolidated net sales for 1985 increased $3.6 billion, or 28 percent, over the prior year to $16.6 billion, principally due to the acquisition of Nabisco Brands, Inc. in the second half of the year (see Note 1 to the Financial Statements). Additionally, tobacco and other food and beverage operations contributed to the sales gain.

For 1985, the consolidated earnings from continuing operations increase of $544 million was mainly the result of the Nabisco Brands acquisition, along with earnings improvements primarily for domestic and international tobacco, and Del Monte.

Net earnings from continuing operations in 1985 increased 19 percent, or $158 million, over the previous year due to the improvements noted above. This gain was partially offset by higher interest and debt expense, primarily associated with the financing of the Nabisco Brands acquisition, and lower interest income.

Net earnings from continuing operations per share increased 80 cents to $3.60 as a result of the net earnings improvements and the comparative effects of the Company's 1984 and 1985 repurchases of common and preferred stocks (see Notes 12 and 13 to the Financial Statements). These stock repurchases added 28 cents per share for the year if effect is given to pro forma adjustments for interest on the funds used to make these repurchases. Due to the acquisition of Nabisco Brands, the 1985 Common Stock repurchase program has been suspended. Nabisco Brands added 4 cents per share for the last six months and full-year 1985 if effect is given to pro forma adjustments for interest on cash used for the acquisition. On a full-year pro forma basis, the acquisition would have resulted in net earnings from continuing operations per share of $3.23 (see Note 1 to the Financial Statements). Traditionally, Nabisco Brands' earnings have been significantly higher in the last half of the year, with the first quarter having the lowest sales and earnings. Therefore, the Company expects dilution of its earnings to be most pronounced in the first quarter of 1986.

Net earnings decreased $209 million in 1985 due to the 1984 gain on the sale of the Company's energy operations and the earnings of discontinued operations.

For 1984, consolidated net sales increased 5.4 percent over the prior year to $13 billion. The improvement was principally due to volume gains and price increases in the domestic tobacco and quick-service restaurant operations.

Consolidated earnings from continuing operations for 1984 increased 16 percent, or $222 million. The improvement was led by higher earnings in the tobacco business, due principally to increased prices along with higher volumes. The food and beverage operations also contributed to the earnings improvement, as a result of volume increases for Kentucky Fried Chicken, improved margins at Del Monte and the inclusion of Canada Dry, acquired in April 1984.

For 1984, net earnings from continuing operations increased $141 million, or 20 percent, and net earnings from continuing operations per share increased 53 cents, or 23 percent. These increases were primarily due to the 1984 earnings improvements noted above, along with higher interest income from investing the proceeds from the disposition of certain operations. Partially offsetting these factors was the comparative effect of the prior year's third quarter debt-for-equity swap, which increased 1983 net earnings from continuing operations by $19 million, or 7 cents per share. During 1984, the Company repurchased 2.8 million shares of its Series A Cumulative Preferred Stock, and in November it repurchased 25 million shares of its Common Stock pursuant to a tender offer (see Notes 12 and 13 to the Financial Statements). These stock transactions added 3 cents to net earnings from continuing operations per share if effect is given to pro forma adjustments for interest on the funds used to make these repurchases.

Net earnings for 1984 rose $329 million to $1.2 billion and net earnings per share increased 42 percent to $4.11. The higher net earnings and earnings per share were due to the gain on the sale of the Company's energy operations of $275 million after taxes, or 98 cents per share, and the increases from continuing operations noted previously. These factors were partially offset by lower earnings from discontinued operations (see Note 16 to the Financial Statements).

The percentage contributions of each of the Company's lines of business to net sales and earnings from continuing operations during the last five years were as follows:

	1985	1984	1983	1982	1981
Net Sales					
Tobacco	49%	60%	61%	67%	72%
Food and beverage	51	40	39	33	28
	100%	100%	100%	100%	100%
Earnings from Continuing Operations					
Tobacco	66%	77%	78%	92%	91%
Food and beverage	34	23	22	8	9
	100%	100%	100%	100%	100%

Information regarding the effects of changing prices is presented on pages 58 and 59 of this report.

Tobacco

The tobacco line of business, which includes the operations of R.J. Reynolds Tobacco Company and R.J. Reynolds Tobacco International, Inc., manufactures and sells tobacco products, principally cigarettes. Products are manufactured in the United States and in 30 foreign countries and territories by subsidiaries or licensees, and are sold in more than 160 markets around the world.

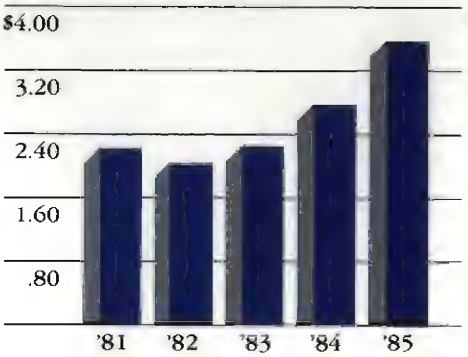
Tobacco sales for 1985 increased $217 million compared with the previous year. The sales gain was due primarily to increased domestic and international prices, along with improved international volumes. The international price and volume gains were offset by unfavorable currency translation effects compared with last year.

Domestic market share for 1985, measured on a manufacturer's shipment basis, remained steady at 31.6 percent, while unit volume declined slightly, in line with the overall industry, to 188.1 billion units. Market share increased at the consumer level due to improved performance from established brands and volume gains from new brands.

In international operations, total unit volume was up 2.5 percent to 86.8 billion, with Camel volume up 7 percent. Camel increased its share

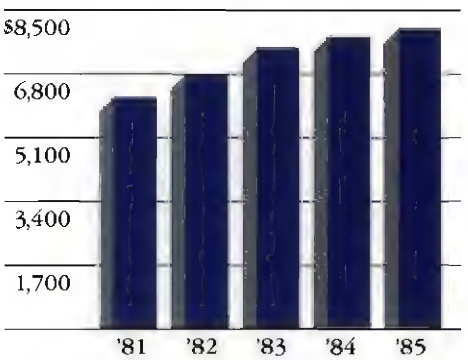
Consolidated Net Earnings from Continuing Operations Per Share

(Dollars)



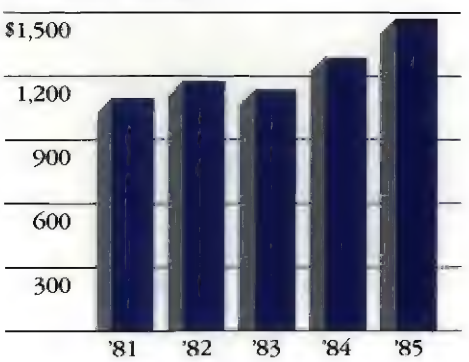
Tobacco Sales

(Dollars in Millions)



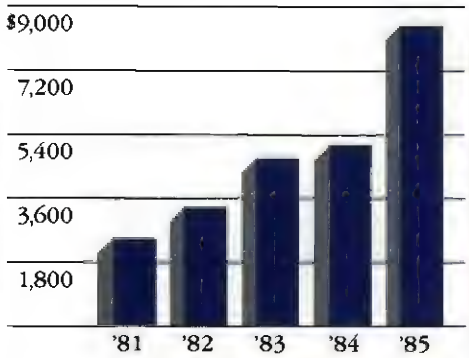
Tobacco Earnings from Operations

(Dollars in Millions)



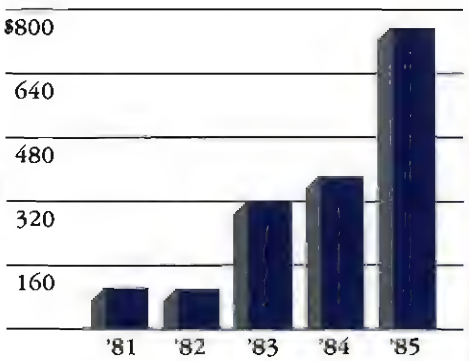
Food and Beverage Sales

(Dollars in Millions)



Food and Beverage Earnings from Operations

(Dollars in Millions)



of market in 9 of its top 10 markets and reached a 3.4 percent share of the European market. Salem and Winston also performed well in their respective regions of emphasis.

For 1985, earnings from operations rose $178 million, or 14 percent, over last year as a result of improved margins for both the domestic and international operations due to higher selling prices, productivity improvements and cost containment efforts. Internationally, higher volume also contributed to the earnings gain.

Sales for the tobacco operations were $7.8 billion for 1984, up $291 million over the prior year. The sales increase was due principally to volume gains and price increases, partially offset by the unfavorable effect of a continued weakening of foreign currencies against the U.S. dollar.

Domestic tobacco volume increased 1.2 percent to 189.7 billion units for 1984, twice the growth rate of the overall cigarette industry. The increase was due largely to the stabilizing of existing brands and the success of new brands introduced in 1983 and 1984. Reflecting this performance, domestic market share increased to 31.6 percent. International volume increased to 84.7 billion units, based on a 13 percent Camel volume increase. Camel was once again the fastest growing international brand.

Earnings from operations were $1.3 billion for 1984, or 13 percent higher than in 1983. The improvement in earnings resulted from higher margins as a result of increased prices, continuing resource management efforts and productivity improvements, as well as volume gains. The improvement occurred even though marketing expenditures increased to support new product introductions and to maintain established brands.

Food and Beverage

The food and beverage line of business includes the operations of Nabisco Brands, Del Monte, Heublein and Kentucky Fried Chicken. Food and beverage products are produced, marketed or distributed worldwide and include cookies, crackers, cereals, confectioneries, snacks, canned and frozen foods, beverages, fresh fruit, spirits and wines, and quick-service retail foods.

Food and beverage sales increased $3.4 billion in 1985 to $8.5 billion, primarily due to the acquisition of Nabisco Brands during the year. Also contributing to the sales growth were increases for the Del Monte, Kentucky Fried Chicken and Heublein operations. The Del Monte gain was due primarily to the 1984 acquisitions of Sunkist and Canada Dry, as well as improved prices and volumes for the fresh fruit operations and higher prices in the frozen and specialty products businesses. Sales improvements for Kentucky Fried Chicken were mainly the result of new store openings. The Heublein sales increase was due to higher volumes and prices in the domestic spirits business and the addition of new brands including Wild Turkey Bourbon, Finlandia Vodka and Mouton-Cadet wines.

For 1985, earnings from operations increased $375 million due mainly to the Nabisco Brands acquisition. The other food and beverage operations also contributed to the earnings growth. Del Monte's earnings improvement was principally the result of the effects of higher prices in the frozen and specialty product, fresh fruit and international grocery operations. Increased earnings for Heublein were mainly due to improved pricing in the domestic spirits business. Additionally, higher earnings for Kentucky Fried Chicken

were due primarily to increased volume from new stores.

In 1984, sales for the food and beverage operations were $5.1 billion, up $371 million, or 7.8 percent over the prior year. The increase was due primarily to the volume increase from new stores and higher selling prices for Kentucky Fried Chicken, and the inclusion of Canada Dry, acquired in April. These gains were partially offset by the unfavorable effects of a weakening of foreign currencies against the U.S. dollar. The year-to-year sales comparison is also affected by low-margin wine and other operations which were sold in late 1983.

Earnings from operations were $388 million for 1984, an increase of 20 percent over 1983. The improvement resulted principally from Kentucky Fried Chicken volume increases, and higher margins attributable to improved pricing and operating efficiencies in Del Monte's grocery product operations worldwide. Also contributing to the higher earnings were increased prices for Heublein's spirits and international beverage operations, and the inclusion of Canada Dry. Partially offsetting these factors were lower earnings from fresh fruit operations as a result of decreased prices due to an industry oversupply of bananas.

Interest and Debt Expense

Interest and debt expense (net of capitalized interest) for 1985 was $356 million, compared with $187 million and $196 million for 1984 and 1983, respectively. The 1985 increase was principally due to the higher level of long-term debt associated with the Nabisco Brands acquisition (see Note 1 to the Financial Statements).

R.J. Reynolds Industries, Inc.

Selected Five-Year Financial Condition Data

(Dollars in Millions Except Per Share Amounts)	1985	1984 (1)	1983	1982	1981
Funds provided by continuing operations	$ 1,655	$1,282	$1,107	$ 775	$ 789
Working capital	$ 1,748	$2,864	$2,962	$2,224	$2,102
Current ratio	1.4	2.3	3.0	2.1	2.4
Total assets	$16,930	$9,272	$9,217	$9,240	$6,935
Return on beginning total assets (2)	12.7%	14.1%	10.6%	13.9%	13.4%
Return on average total assets	9.0%	14.1%	10.6%	11.9%	12.7%
Total debt (3)	$ 5,695	$1,585	$1,590	$1,967	$1,528
Preferred stocks	1,587	499	631	630	345
Common stockholders' equity	4,796	4,478	5,223	4,766	3,927
Total capital	$12,078	$6,562	$7,444	$7,363	$5,800
Return on beginning total capital (4)	18.0%	17.5%	13.3%	16.6%	15.9%
Return on average total capital	12.7%	18.6%	13.2%	14.6%	15.2%
Total debt as a percentage of total capital (5)	47.2%	24.2%	21.4%	26.7%	26.3%
Return on beginning common stockholders' equity (6)	20.3%	22.1%	17.2%	21.2%	21.4%
Return on average common stockholders' equity	19.6%	23.8%	16.4%	19.2%	20.0%
Capital expenditures	$ 1,194	$ 813	$ 609	$ 377	$ 298
Book value per common share (7)	$ 19.14	$17.33	$18.44	$16.93	$15.05

The 1985 amounts include the operations of Nabisco Brands, Inc. from July 2, 1985 (see Note 1 to the Financial Statements).

(1) Net earnings for 1984 include a $275 million gain on the sale of the Company's energy operations (see Note 16 to the Financial Statements).

(2) Net earnings plus after-tax interest and debt expense divided by beginning total assets.

(3) Total debt consists of notes payable and long-term debt (including current maturities).

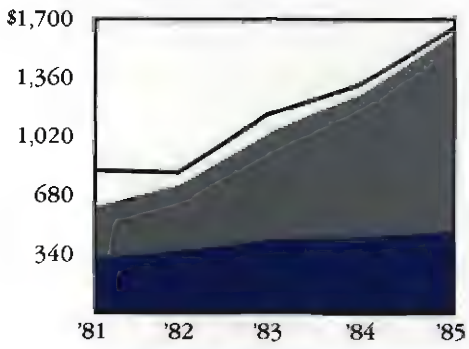
(4) Net earnings plus after-tax interest and debt expense divided by beginning total capital.

(5) At December 31, 1985, 1984, 1983, 1982 and 1981, the sum of total debt and redeemable preferred stocks as a percentage of total capital was 60.3 percent, 31.8 percent, 29.8 percent, 35.3 percent and 32.2 percent, respectively.

(6) Net earnings applicable to Common Stock divided by beginning common stockholders' equity.

(7) Book value amounts for prior years have been restated to give effect to a two and one-half for one Common Stock split (see Note 13 to the Financial Statements).

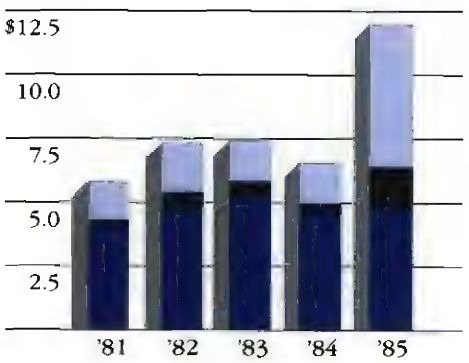
Funds Provided by Continuing Operations, Capital Expenditures and Cash Dividends
(Dollars in Millions)



– Funds Provided by Continuing Operations
■ Capital Expenditures
■ Cash Dividends

Composition of Capital

(Dollars in Billions)



■ Total Debt
■ Preferred Stocks
■ Common Stockholders' Equity

Financial Condition

Funds Provided by Continuing Operations

Funds provided by continuing operations were $1.7 billion in 1985 compared with $1.3 billion in 1984 and $1.1 billion in 1983. The increases in funds provided by continuing operations were due to higher levels of earnings. Internally generated funds from operations represent a major source of funds available to the Company.

During 1985, funds provided by continuing operations were sufficient to meet capital expenditures and cash dividends, even though capital expenditures increased by 47 percent in 1985 compared with the prior year (see "Capital Expenditures" discussion on page 39). Over the past five years, funds provided by continuing operations totaled $5.6 billion. These funds were principally used for capital expenditures and cash dividends, leaving $416 million of internally generated funds available for other Company purposes. In the future, the Company expects that internally generated funds will continue to be more than sufficient to meet projected capital expenditures and cash dividends.

Working Capital and Liquidity

At December 31, 1985, working capital was $1.7 billion compared with $2.9 billion at year-end 1984. The current ratio was 1.4 compared with 2.3 for the prior year end. The declines in working capital and the current ratio were principally due to the Company's repurchases and redemptions of common and preferred stocks (see "Capital Resources" discussion below), the Nabisco Brands acquisition and retirements of long-term debt. The Nabisco Brands acquisition was a major factor in the year-to-year balance sheet changes in the components of working capital (see Note 1 to the Financial Statements).

The Company believes that its continued favorable current ratio is an important indicator of its ability to meet short-term obligations. A further indication of the Company's favorable liquidity position is the fact that a significant portion of current assets are LIFO inventories, which are carried at values substantially less than current cost. The current cost of inventories was $1.4 billion more than the amounts at which they were carried on the 1985 Balance Sheet (see Note 5 to the Financial Statements).

During 1985, the Company continued to maintain seasonal credit facilities with various banks. The Company also entered into revolving credit agreements and a Eurodollar credit facility, which expire in 1988. (See Notes 8 and 10 to the Financial Statements.) The credit available through these facilities ensures the Company's access to credit markets and the availability of significant financial resources, as well as operational flexibility. Unused credit facilities totaled $1.3 billion at year-end 1985, including $991 million to support outstanding commercial paper. The Company utilizes commercial paper to fund seasonal working capital requirements as needed.

Capital Resources

In 1985, the Company acquired Nabisco Brands at a total cost of $4.9 billion in a two-part purchase. The cash tender offer for 50.2 percent of

Nabisco Brands Common Stock totaled $2.5 billion, of which approximately $2 billion was financed by external borrowings. To complete the acquisition, the Company issued $1.2 billion of 11.20% Notes and $1.2 billion of Series C Cumulative Preferred Stock in exchange for the remaining shares of Nabisco Brands Common Stock. As a result of the acquisition, the Company suspended its 1985 program to repurchase up to 17.5 million shares of Common Stock. Prior to the acquisition, the Company had repurchased 7.9 million shares of Common Stock in 1985 at a total cost of $248 million. Also during 1985, the Company redeemed or purchased $130 million of Series A Cumulative Preferred Stock. In January 1986, the Company called for the redemption of all remaining shares of the Series A Cumulative Preferred Stock on March 1, 1986. (See Notes 1, 10, 12 and 13 to the Financial Statements.)

Total capital rose to $12.1 billion at December 31, 1985, compared with $6.6 billion for the prior year end, due principally to financing related to the Nabisco Brands acquisition and short-term borrowings for seasonal working capital requirements. Consequently, total debt as a percentage of total capital at December 31, 1985, rose to 47 percent compared with 24 percent at year-end 1984, and the sum of total debt and redeemable preferred stocks as a percentage of total capital increased to 60 percent from 32 percent for the previous year.

Although the Nabisco Brands acquisition has significantly changed the Company's capitalization, the Company believes its long-term financial position remains strong and that it has the ability to finance operations as necessary. The Company also believes that the debt-to-capital ratios will improve over time as internally generated funds are expected to exceed projected capital expenditures and cash dividends. Should the need for external financing arise, the Company expects to have continued access to short-term credit markets to fund seasonal working capital requirements and to have the ability to raise additional funds in the long-term debt market.

Capital Expenditures

Consolidated capital expenditures for 1985 were $1.2 billion compared with $813 million in 1984 and $609 million in 1983. Tobacco capital expenditures accounted for 54 percent of the 1985 consolidated total, while food and beverage expenditures were 44 percent of the total.

In the tobacco business, capital expenditures during 1985 were $647 million compared with $527 million for the prior year. The expenditures for both years were for the expansion and modernization of facilities worldwide, principally for a new manufacturing complex in North Carolina. The new cigarette plant began initial production in January 1986 and is expected to be at full production by the end of 1987.

Food and beverage capital expenditures totaled $527 million in 1985 compared with $257 million in 1984. The increase was primarily due to the capital expenditures of Nabisco Brands and the continued construction and upgrading of Kentucky Fried Chicken stores worldwide.

Capital expenditures are currently projected to total $3.2 billion over the next three years compared with

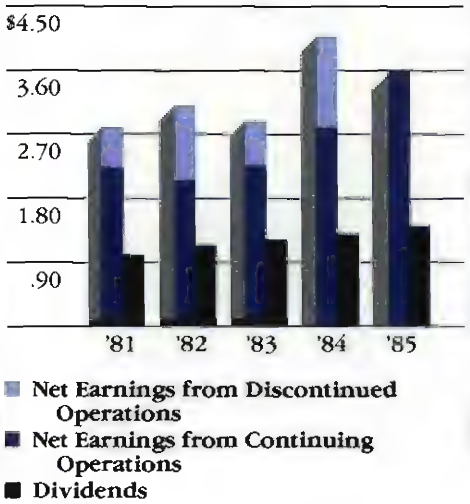
1981-1985 Capital Expenditures by Line of Business

- Tobacco
- Food and Beverage
- Corporate

1986-1988 Projected Capital Expenditures by Line of Business

- Tobacco
- Food and Beverage
- Corporate

Net Earnings Per Common Share and Dividends Per Common Share



$2.6 billion for the last three years. The projected increase is due to the inclusion of Nabisco Brands, which more than offsets lower projected capital expenditures for other operations. Over this period, food and beverage capital expenditures are expected to increase to approximately 54 percent of the consolidated total, principally for the modernization and expansion of facilities. Tobacco capital expenditures are projected to account for approximately 45 percent of consolidated capital expenditures, principally for the domestic tobacco plant modernization program which should be substantially completed by the end of this period. The Company expects to satisfy its capital needs using funds generated from operations.

Foreign Currency

The Company has operations in many countries, utilizing 33 functional currencies in its more than 400 subsidiaries and branches. The major functional currency is the U.S. dollar. Significant foreign currency net investments are located in Canada, the United Kingdom, France, West Germany and the Philippines. Changes in the strength of these countries' currencies relative to the U.S. dollar result in direct charges or credits to the equity section on the Consolidated Balance Sheets. The Company also has significant exposure to foreign exchange sale and purchase transactions in currencies other than a functional currency. The exposures include the British pound, U.S. dollar, West German mark, Malaysian ringgit and Swiss franc. The Company continually monitors these exposures to minimize the effects of foreign currency translation on its earnings. During 1985, the Company incurred $425 million of long-term debt denominated in foreign currencies in connection with the Nabisco Brands acquisition. The Company also entered into hedging arrangements which will offset the effects of future exchange rate movements on these debt issues.

Although fluctuations in the value of foreign currencies cause U.S. dollar translated amounts to change in comparison with previous periods, the Company cannot quantify in any meaningful way the effect of such fluctuations upon future earnings. This is due to the large number of currencies involved, the constantly changing exposure to these currencies, the complexity of intercompany relationships, the hedging activity entered into to minimize the effect of rate changes and the fact that all foreign currencies do not react in the same manner against the U.S. dollar.

Dividends and Stock Prices

The Company's Common Stock is listed on the New York Stock Exchange (trading symbol: RJR) and on stock exchanges in London, Geneva, Zurich, Basel, Frankfurt, Dusseldorf, West Berlin, Amsterdam, Paris, Brussels and Antwerp. The number of common stockholders of record

at December 31, 1985 was 108,884.

The Company's preferred stocks are listed and traded only in the United States. The Company has paid all regular quarterly dividends on its preferred stocks. The regular quarterly dividends per share are: Series A - $1.025; Series B - $2.875; and Series C - $3.24 (issued September 10, 1985, see Notes 1 and 12 to the Financial Statements).

The following table sets forth the dividends paid per share of Common Stock and the high and low sales prices, taken from the Composite Tape as reported by *The Wall Street Journal*, for the common and preferred stocks during the last two years:

	Common Stock		Cumulative Preferred Stocks		
			Series A	Series B	Series C (1)
Quarters	Dividends	Market Price (high-low)	Market Price (high-low)	Market Price (high-low)	Market Price (high-low)
1985					
First	$ .34	$34¼ — 27¾	$49¼ — 47⅞	$110⅝ — 103½	$ —
Second	.35	35 — 28¾	50 — 48½	112¼ — 107⅞	—
Third	.35	31¾ — 25½	49¼ — 48	110¾ — 108	129¾ — 123¾
Fourth	.37	33⅜ — 24¾	50 — 48	113½ — 109⅝	132¼ — 127⅞
Year	$1.41	$35 — 24¾	$50 — 47⅞	$113½ — 103½	$132¼ — 123¾
1984 (2)					
First	$ .32	$26¾ — 21¾	$47⅝ — 45½	$106¾ — 102¼	—
Second	.32	26 — 21⅛	47½ — 46⅛	105 — 100½	—
Third	.32	27¼ — 22½	48 — 46⅜	105¼ — 101⅜	—
Fourth	.34	29 — 25¾	48¾ — 47½	107½ — 103½	—
Year	$1.30	$29 — 21⅛	$48¾ — 45½	$107½ — 100½	—

(1) The 1985 third quarter high and low market price for the Series C Stock was for the period September 10 through September 30.

(2) The 1984 dividends and market price data for Common Stock have been restated to give effect to a two and one-half for one Common Stock split (see Note 13 to the Financial Statements).

R.J. Reynolds Industries, Inc.

Consolidated Financial Statements

The Summary of Significant Accounting Policies below, the Notes to Consolidated Financial Statements on pages 46 through 53, the Lines of Business and Geographic Data for 1985, 1984 and 1983 on pages 56 and 57 and the Inflation Accounting Data on pages 58 and 59 are integral parts of the accompanying financial statements.

Summary of Significant Accounting Policies

This summary of significant accounting policies is presented to assist in understanding the Company's financial statements included in this report. These policies conform to generally accepted accounting principles and have been consistently followed by the Company in all material respects.

Consolidation

The Company includes in its consolidated financial statements the accounts of the parent and all subsidiaries.

Inventories

In all of the Company's businesses, inventories are stated at the lower of cost or market. Various methods are used for determining cost as described below.

The cost of domestic inventories is determined principally by the LIFO method. The cost of remaining inventories is determined using the FIFO, specific lot and weighted average methods. In accordance with recognized trade practices, stocks of tobacco and bulk whiskey and wine, which must be cured or aged for more than one year, are classified as current assets.

Depreciation and Amortization

Property, plant and equipment are depreciated principally by the straight-line method.

Trademarks, Goodwill and Other Intangibles

Trademarks and goodwill are generally being amortized on a straight-line basis over a 40-year period.

Other Income and Expense

The Company includes in "Other income (expense), net" items of a financial nature, principally interest income.

Income Taxes

The Company uses the flow-through method in accounting for investment tax credits, whereby the provision for income taxes is reduced in the year the tax credits first become available.

R.J. Reynolds Industries, Inc.

Consolidated Statements of Earnings and Earnings Retained

For the Years Ended December 31

(Dollars in Millions Except Per Share Amounts)	1985	1984	1983
Net sales (Note 2)	**$16,595**	$12,974	$12,312
Costs and expenses:			
Cost of products sold	**10,127**	8,282	8,226
Selling, advertising, administrative and general expenses	**4,305**	3,073	2,689
Earnings from continuing operations	**2,163**	1,619	1,397
Interest and debt expense (net of capitalized amounts of $68, $29 and $9, respectively)	**(356)**	(187)	(196)
Other income (expense), net (Note 16)	**47**	120	87
Earnings from continuing operations before provision for income taxes	**1,854**	1,552	1,288
Provision for income taxes (Note 3)	**853**	709	586
Net earnings from continuing operations	**1,001**	843	702
Net earnings from discontinued operations (Note 16)	**—**	92	179
Gain on sale of energy operations, net of taxes (Note 16)	**—**	275	—
Net earnings	**1,001**	1,210	881
Less preferred dividends	**91**	56	62
Net earnings applicable to Common Stock	**910**	1,154	819
Earnings retained at beginning of year	**4,034**	4,461	3,987
Less:			
Cash dividends on Common Stock	**357**	360	345
Distribution of Sea-Land stock (Note 16)	**—**	540	—
Retirement of Common Stock (Note 13)	**230**	681	—
Earnings retained at end of year	**$ 4,357**	$ 4,034	$ 4,461
Net earnings per common share (Note 13):			
Continuing operations	**$ 3.60**	$ 2.80	$ 2.27
Discontinued operations	**—**	1.31	0.63
	$ 3.60	$ 4.11	$ 2.90
Average number of common shares outstanding (in thousands)	**252,941**	280,938	282,492

The 1985 amounts include the operations of Nabisco Brands, Inc. from July 2, 1985 (see Note 1).

R.J. Reynolds Industries, Inc.

Consolidated Statements of Changes in Financial Position

For the Years Ended December 31

(Dollars in Millions)	1985	1984	1983
Funds provided by continuing operations:			
Net sales	$16,595	$12,974	$12,312
Less operating costs and expenses which required the outlay of working capital	14,940	11,692	11,205
Total funds provided by continuing operations	1,655	1,282	1,107
Funds required by continuing operations:			
Change in working capital resulting from operations (see below)	(76)	(31)	(318)
Capital expenditures	1,194	813	609
Miscellaneous acquisitions	33	292	16
Disposals of property, plant and equipment	(74)	(39)	(77)
Cash dividends	448	416	407
Cumulative translation adjustments	21	39	26
Other	254	110	116
Total funds required by continuing operations	1,800	1,600	779
Net funds provided (required) by continuing operations	(145)	(318)	328
Funds provided (required) by financing transactions:			
Net change in current notes payable*	441	(31)	(204)
Issuance of long-term debt	3,345	57	245
Retirements of long-term debt	(541)	(41)	(413)
Issuance of Company's stocks (Notes 12 and 13)	1,241	11	36
Repurchases of Company's stocks (Notes 12 and 13)	(403)	(877)	—
Net funds provided (required) by financing transactions	4,083	(881)	(336)
Net change in funds related to discontinued operations (Note 16)	—	2,159	125
Net funds required for acquisition of Nabisco Brands, Inc. (Note 1)	(4,672)	—	—
Increase (decrease) in cash and short-term investments	$ (734)	$ 960	$ 117
Analysis of change in working capital resulting from operations*:			
Funds required (provided) by the change in:			
Accounts and notes receivable	$ 142	$ 437	$ (69)
Inventories	(15)	(197)	(363)
Prepaid expenses	26	8	11
Accounts payable and accrued accounts	(499)	(225)	21
Income taxes accrued	270	(54)	82
Change in working capital resulting from operations	$ (76)	$ (31)	$ (318)

*Does not include Nabisco Brands, Inc. amounts at date of acquisition (see Note 1) or items related to discontinued operations.

R.J. Reynolds Industries, Inc.

Consolidated Balance Sheets

December 31

(Dollars in Millions)	1985	1984
Assets		
Current assets:		
Cash and short-term investments (Note 4)	$ 589	$ 1,323
Accounts and notes receivable (less allowances of $87 and $46, respectively)	1,944	1,226
Inventories (Note 5)	3,209	2,493
Prepaid expenses	136	72
Total current assets	5,878	5,114
Property, plant and equipment — at cost (Notes 1 and 6)	6,628	3,760
Less depreciation and amortization	1,169	944
Net property, plant and equipment	5,459	2,816
Trademarks, goodwill and other intangibles (Notes 1 and 7)	4,921	1,055
Other assets and deferred charges	672	287
	$ 16,930	$ 9,272
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable (Note 8)	$ 666	$ 101
Accounts payable and accrued accounts (Note 9)	3,060	1,459
Current maturities of long-term debt (Note 10)	172	227
Income taxes accrued	232	463
Total current liabilities	4,130	2,250
Long-term debt (less current maturities) (Note 10)	4,857	1,257
Other noncurrent liabilities	845	265
Deferred income taxes	715	523
Commitments and contingencies (Note 11)		
Redeemable preferred stocks — net (Note 12)	1,587	499
Common stockholders' equity:		
Common Stock — net (Note 13) (250,566,461 shares outstanding)	247	255
Paid-in capital (Note 13)	332	344
Cumulative translation adjustments (Note 14)	(140)	(155)
Earnings retained	4,357	4,034
Total common stockholders' equity	4,796	4,478
	$ 16,930	$ 9,272

R.J. Reynolds Industries, Inc.

Notes to Consolidated Financial Statements

(Dollars in Millions Except Per Share Amounts)

Note 1
Acquisition

During 1985, the Company acquired Nabisco Brands, Inc., a global producer and marketer of cookies, crackers, cereals, confectioneries, snacks and other grocery products. Pursuant to a Merger Agreement entered into June 1, 1985, the Company purchased 29 million shares, or 50.2 percent of the outstanding shares, of Nabisco Brands Common Stock on July 2, 1985, for $85 per share pursuant to a cash tender offer. On September 10, 1985, the acquisition was completed upon the conversion of each remaining share of Nabisco Brands Common Stock outstanding into .34 of one share of the Company's new Series C Cumulative Preferred Stock, $125 stated value per share, and $42.50 principal amount of 11.20% Notes, due August 1, 1997 (see Notes 10 and 12).

The total cost of the acquisition, which was accounted for as a purchase, was $4.9 billion. The Company's consolidated results of operations include the operations of Nabisco Brands from July 2, 1985, net of minority interest for the appropriate period. The net assets of Nabisco Brands have been included in these financial statements at values representing a preliminary allocation of the purchase price. Although final asset and liability valuations will affect this allocation, they are not expected to have a material effect on the financial statements.

The effect of the Nabisco Brands acquisition on the 1985 Consolidated Statement of Changes in Financial Position is shown in the following table:

Acquisition:	
Current assets	$ 1,593
Property, plant and equipment	1,808
Trademarks, goodwill and other intangibles	3,942
Other assets and deferred charges	219
Current liabilities	(1,298)
Long-term debt	(685)
Other noncurrent liabilities	(659)
Total funds required for acquisition of Nabisco Brands	4,920
Less cash and short-term investments	248
Net funds required for acquisition	$ 4,672

The unaudited pro forma combined results of continuing operations shown in the following table assume that the Nabisco Brands acquisition had taken place as of the beginning of the periods presented:

	1985	1984
Net sales	$19,448	$19,227
Net earnings from continuing operations	984	877
Net earnings from continuing operations per common share	3.23	2.47

The following summarized financial information of legal entity Nabisco Brands is based on the total cost of the acquisition to the Company:

	1985
At December 31:	
Current assets	$ 1,689
Net property, plant and equipment	1,886
Trademarks, goodwill and other intangibles	3,893
Other assets and deferred charges	244
Current liabilities	(1,481)
Long-term debt	(465)
Other noncurrent liabilities	(670)
For the period July 2 — December 31:	
Net sales	$ 3,362
Earnings from continuing operations	357
Net earnings from continuing operations	141

Note 2
Excise Taxes

Net sales included excise taxes as indicated in the following table:

	1985	1984	1983
Tobacco	$2,640	$2,667	$2,746
Food and beverage	422	392	405
	$3,062	$3,059	$3,151

Note 3
Provision for Income Taxes

The provision for income taxes consisted of the following:

	1985	1984	1983
Current:			
Federal	$565	$456	$344
State	83	68	51
Foreign	129	87	57
	777	611	452
Deferred:			
Federal	38	84	115
State	22	13	12
Foreign	16	1	7
	76	98	134
Provision for income taxes	$853	$709	$586

Deferred income tax expense results from timing differences in the recognition of revenue and expense for book and tax purposes. The sources of these differences and the tax effect of each were as follows:

	1985	1984	1983
Excess of tax over book depreciation	$107	$55	$ 40
Various other items	(31)	43	94
Deferred income taxes	$ 76	$98	$134

Pretax income from continuing operations for domestic and foreign operations is shown in the following table:

	1985	1984	1983
Domestic (includes U.S. exports)	$1,415	$1,248	$1,052
Foreign*	439	304	236
	$1,854	$1,552	$1,288

*Pretax income of foreign operations is earnings of all operations located outside the United States, some of which may also be currently subject to U.S. tax jurisdiction.

The differences between the provision for income taxes and income taxes computed at the statutory U.S. federal income tax rate are explained as follows:

	1985	1984	1983
Income taxes computed at 46% statutory U.S. federal income tax rate	$853	$714	$592
Taxes on foreign operations less than the statutory U.S. federal income tax rate	(25)	(19)	(17)
State taxes, net of federal benefit	56	43	34
Investment tax credit	(67)	(55)	(35)
Miscellaneous items	36	26	12
Provision for income taxes	$853	$709	$586
Effective tax rate	46.0%	45.7%	45.5%

At December 31, 1985, there were $1.6 billion of accumulated and undistributed earnings of foreign subsidiaries (including those of Nabisco Brands) for which no provision for U.S. federal income taxes had been made. These undistributed earnings are intended to be reinvested abroad indefinitely or repatriated substantially free of additional tax.

There are a number of issues pending as a result of Internal Revenue Service audits. The resolution of these issues is not expected to have a material effect on the Company's financial position.

Note 4
Cash and Short-term Investments

Short-term investments at December 31, 1985 and 1984, valued at cost (approximate market), totaled $410 million and $1.1 billion, respectively. Short-term investments at December 31, 1985, principally consisted of commercial paper, repurchase agreements with banks, which were secured by U.S. government securities, and Eurodollar time deposits.

Note 5
Inventories

The major classes of inventory and the amount of each at December 31 were:

	1985	1984
Leaf tobacco	$1,107	$1,174
Finished products	1,040	659
Bulk whiskey and wine	129	125
Raw materials	502	256
Other	431	279
	$3,209	$2,493

At December 31, 1985 and 1984, $1.8 billion and $1.7 billion, respectively, of the inventory was valued by the LIFO method. The balance of the inventory was valued by various other methods, principally FIFO.

The current cost of inventories at December 31, 1985 and 1984 was greater than the amounts at which these inventories were carried on the balance sheets by $1.4 billion and $1.7 billion, respectively.

Note 6
Property, Plant and Equipment

Components of property, plant and equipment at December 31 are shown in the following table:

	1985	1984
Land and land improvements	$ 394	$ 301
Buildings and leasehold improvements	1,487	842
Machinery and equipment	3,571	1,928
Construction-in-process	1,176	689
	$6,628	$3,760

Note 7
Trademarks, Goodwill and Other Intangibles

This account consisted of the following items, valued at cost, at December 31:

	1985	1984
Trademarks	$ 559	$ 526
Goodwill	4,391	542
Other intangibles	125	72
	5,075	1,140
Less amortization	154	85
	$4,921	$1,055

Note 8
Notes Payable and Related Information

Notes payable consisted of the following at December 31:

	1985	1984
Commercial paper	$536	$ —
Notes payable, principally to foreign banks	130	101
	$666	$101

Short-term bank borrowings were generally made in the form of demand notes under lines of credit established as part of the Company's banking arrangements at rates which approximated the minimum commercial interest rates prevailing at the dates of borrowing. Unused lines of credit at December 31, 1985, totaled $1.3 billion and included $991 million to support outstanding domestic commercial paper. Of these lines at December 31, 1985, $580 million was in the form of seasonal credit facilities, $350 million was in the form of revolving credit agreements extending until June 2, 1988, and $400 million was in the form of a Eurodollar credit facility extending until November 20, 1988 (see Note 10).

Note 9
Accounts Payable and Accrued Accounts

Accounts payable and accrued accounts consisted of the following at December 31:

	1985	1984
Trade accounts	$ 696	$ 297
Marketing and advertising	461	192
Payroll and employee benefits	429	193
Excise tax	271	219
Other	1,203	558
	$3,060	$1,459

Note 10
Long-term Debt

	December 31, 1985		December 31, 1984	
	Due Within One Year	Due After One Year (1)	Due Within One Year	Due After One Year
Long-term debt consisted of the following:				
7⅜-8.90% Debentures, with semiannual and annual sinking fund payments through 2007 (reduced by $89 million and $93 million of such debentures held by the Company on December 31, 1985 and 1984, respectively, for future sinking fund requirements)	$ 6	$ 248	$ 6	$ 261
11.35-13.35% Sinking Fund Debentures, due through 2015, with annual sinking fund payments beginning in 1993	—	700	—	200
8⅜-9¾% Notes, due through 1986	100	—	190	100
10-10⅞% Notes, due 1988 to 1993	—	949	—	250
11.20% Notes, due 1997	—	1,200	—	—
9.66-10.91% effective interest rates, foreign currency debt, due 1990 to 2000 (2)	—	426	—	—
Zero Coupon Guaranteed Notes, due 1992, net of discount of $227 million and $249 million at December 31, 1985 and 1984, respectively, effective interest rate of 14.64%	—	173	—	151
Revolving credit agreements with various banks, due 1988 (3)	—	500	—	—
Other indebtedness	66	661	31	295
	$172	$4,857	$227	$1,257

(1) The payment schedule of debt due through 1990 is as follows (in millions): 1987 - $99; 1988 - $663; 1989 - $250; and 1990 - $409.

(2) The Company has entered into hedging arrangements which will offset the effects of future exchange rate movements on these debt issues.

(3) The Company has revolving credit agreements with various domestic banks expiring in 1988, under which it may borrow up to $850 million. Under these agreements, the Company is obligated to pay a commitment fee of ¼ of 1 percent per annum on the amount of unused available borrowings. The Company also has a three-year Eurodollar credit facility with various foreign banks and foreign branches of domestic banks under which the Company has commitments for up to $400 million in borrowings. Under the facility agreement, the Company is obligated to pay a commitment fee of 1/10 of 1 percent per annum on the committed amount. At December 31, 1985, these agreements supported $500 million of short-term notes that have been classified as long-term based upon the Company's intention to continue that amount of debt in some form for more than one year.

Note 11
Contingencies

Various legal actions, proceedings and claims are pending or may be instituted against the Company, including those claiming that lung cancer and other diseases have resulted from the use of the Company's tobacco products. Some of the foregoing involve or may involve claims for compensatory, punitive or other damages in substantial amounts. During 1985, 30 new actions by individuals alleging death or diseases due to the use of the Company's tobacco products were filed, seven such actions were withdrawn or dismissed prior to trial and two such actions were resolved in favor of the Company in trial court proceedings. The plaintiffs have appealed the two trial decisions favorable to the Company. A total of 45 such cases were pending at December 31, 1985. In addition, the Company was served in 1985 with cross-complaints in approximately 320 cases in which it was claimed by an asbestos manufacturer that certain asbestos-related injuries for which the asbestos manufacturer was being sued were caused in part by the use of tobacco products. All such cross-complaints were dismissed on procedural grounds in 1985.

Litigation is subject to many uncertainties and it is possible that some of the legal actions, proceedings or claims referred to above could be decided unfavorably to the Company. The Company believes that it has meritorious defenses to these claims, actions and proceedings and that they should not have any material adverse effect on the Company's financial position.

Note 12
Redeemable Preferred Stocks

The Company had three series of cumulative preferred stock (Series A, B and C) outstanding at December 31, 1985. The stocks have equal rank and are senior to the Common Stock.

In January 1986, the Company called for the redemption of all remaining shares of its Series A Stock, on March 1, 1986, at $48.50 per share plus accrued dividends. Dividends on Series A Stock were $9 million in 1985, $23 million in 1984 and $29 million in 1983.

The Series B Stock is subject to mandatory redemption of 327,375 shares per year, commencing November 1, 1989, at a redemption price of $100 per share plus any accrued dividends. The Company has the noncumulative option to double the amount redeemed pursuant to such mandatory redemption in any year. Also, beginning November 1, 1989, the Company may elect to redeem the Series B Stock, in addition to the mandatory redemption requirement, in whole or in part, at an optional redemption price of $100 plus the annual dividend together with any accrued dividends. Such optional redemption price will be reduced by 20 percent of the annual dividend on each subsequent November 1, declining to $100 plus accrued dividends on November 1, 1994, and thereafter. Each share entitles the holder to receive cumulative dividends, payable quarterly, at an annual rate of $11.50. Dividends on Series B Stock totaled $33 million in 1985, 1984 and 1983. Additionally, each share entitles the holder to one vote on all matters on which holders of Common Stock have the right to vote, voting together with all other shares entitled to vote and not as a class.

The Company issued 9,750,095 shares of the Series C Stock in the Nabisco Brands acquisition (see Note 1). The Series C Stock is subject to mandatory redemption of 1,084,211 shares per year, commencing October 1, 1992, at a redemption price of $125 per share plus any accrued dividends. The Company has the noncumulative option to double the amount redeemed pursuant to such mandatory redemption in any year. The Company may elect to redeem the Series C Stock, in whole or in part, at redemption prices commencing at $136.25 on October 1, 1985, and declining to $125 on October 1, 1996. Each share entitles the holder to receive cumulative dividends, payable quarterly, at an annual rate of $12.96. Dividends on Series C Stock totaled $49 million in 1985. The Series C Stock is non-voting except in limited circumstances.

Changes in the redeemable preferred stocks are summarized in the table on the following page:

	1985		1984		1983	
	Shares	Amount	Shares	Amount	Shares	Amount
Series A Cumulative Preferred Stock — without par value ($48.50 stated value — authorized 1,634,676 shares at December 31, 1985):						
Balance at beginning of year	7,053,478	$ 342	7,053,478	$ 342	7,053,478	$342
Shares redeemed and retired	(2,014,320)	(98)	—	—	—	—
Treasury shares retired	(3,404,664)	(165)	—	—	—	—
	1,634,494	79	7,053,478	342	7,053,478	342
Less treasury stock:						
Balance at beginning of year	(2,801,856)	(133)	—	—	—	—
Shares purchased	(644,617)	(32)	(2,801,856)	(133)	—	—
Shares retired	3,404,664	163	—	—	—	—
	(41,809)	(2)	(2,801,856)	(133)	—	—
Balance at end of year	1,592,685	$ 77	4,251,622	$ 209	7,053,478	$342
Series B Cumulative Preferred Stock — without par value ($100 stated value — authorized 2,917,115 shares at December 31, 1985):						
Balance at beginning of year	2,899,112	$ 290	2,891,518	$ 289	2,880,582	$288
Shares issued upon conversion of 4½% Convertible Subordinated Debentures	12,183	1	7,594	1	10,936	1
	2,911,295	291	2,899,112	290	2,891,518	289
Less treasury stock:						
Balance at beginning of year	(4,774)	—	(4,167)	—	(1,572)	—
Shares returned under Restricted Share awards and other	—	—	(607)	—	(2,595)	—
	(4,774)	—	(4,774)	—	(4,167)	—
Balance at end of year	2,906,521	$ 291	2,894,338	$ 290	2,887,351	$289
Series C Cumulative Preferred Stock — without par value ($125 stated value — authorized 10,000,000 shares at December 31, 1985):						
Shares issued in Nabisco Brands acquisition (see Note 1)	9,750,095	$1,219	—	—	—	—
Balance at end of year	9,750,095	$1,219	—	—	—	—

Note 13
Common Stock and Paid-in Capital

A two and one-half for one split of the Company's Common Stock, without par value, became effective May 17, 1985. Accordingly, the stated value of the Common Stock was reduced from $2.50 to $1.00 per share. The split had no effect on total common stockholders' equity.

All references in the Financial Statements to the number of common shares, earnings and dividend amounts per share, stock option data and other per share amounts have been restated to give effect to the stock split.

	1985		1984		1983	
	Shares	**Amount**	Shares	Amount	Shares	Amount
Common Stock — no par ($1 stated value — authorized 300,000,000 shares at December 31, 1985):						
Balance at beginning of year	**258,548,528**	**$259**	283,499,628	$ 284	281,948,858	$282
Shares issued upon conversion of 4½% Convertible Subordinated Debentures	**78,932**	**—**	48,900	—	70,205	—
Shares repurchased and retired*	**(7,929,059)**	**(8)**	(25,000,000)	(25)	—	—
Shares issued upon acquisition of debentures	**—**	**—**	—	—	1,478,240	2
Other	**—**	**—**	—	—	2,325	—
	250,698,401	**251**	258,548,528	259	283,499,628	284
Less treasury stock:						
Balance at beginning of year	**(165,273)**	**(4)**	(316,608)	(4)	(457,523)	(5)
Shares purchased	**(850,000)**	**(25)**	(250,000)	(6)	—	—
Shares issued under incentive compensation plan awards, net	**883,333**	**25**	401,335	6	140,915	1
	(131,940)	**(4)**	(165,273)	(4)	(316,608)	(4)
Balance at end of year	**250,566,461**	**$247**	258,383,255	$ 255	283,183,020	$280
Paid-in capital:						
Balance at beginning of year		**$344**		$ 585		$553
Distribution of Sea-Land stock		**—**		(213)		—
Common Stock repurchased and retired*		**(10)**		(32)		—
Excess of total value of common shares issued upon acquisition of debentures over stated value		**—**		—		28
Other		**(2)**		4		4
Balance at end of year		**$332**		$ 344		$585

*The aggregate cost to the Company, including all related fees and expenses, was $248 million and $738 million, respectively. The excess of the cost of shares repurchased and retired over the stated value has been charged to earnings retained, $230 million in 1985 and $681 million in 1984, and paid-in capital, $10 million in 1985 and $32 million in 1984.

The Company has three stock option plans that provide for the granting of options to purchase shares of the Company's Common Stock to certain officers and other employees. These plans permit the granting of incentive awards in the form of incentive stock options (ISOs), stock appreciation rights (SARs) and other stock options. The option price for outstanding options is the average quoted market price on the date of grant. Options that subsequently lapse or are canceled are added back to shares authorized for future grants.

Under the 1982 Long-Term Incentive Plan, the maximum number of shares of Common Stock that may be granted is 12,500,000. As of December 31, 1985, there were 1,566,847 ISOs (88,910 of which have SARs attached) and 1,959,664 other stock options/SARs outstanding with expiration dates ranging from June 16, 1987 to September 18, 1995. The average exercise price was $24.48, and such options were held by 384 participants.

Under the 1977 Stock Option Plan, the maximum number of shares of Common Stock that may be granted is 6,250,000. As of December 31, 1985, there were 1,316,443 options/SARs outstanding with expiration dates ranging from September 14, 1987 to December 18, 1995. The average exercise price was $19.72, and such options/SARs were held by 229 participants.

Under the Career Executive Stock Plan, the total number of shares of Common Stock granted was 2,944,556. No additional shares may be granted under this plan, which has expired. As of December 31, 1985, there were 75,340 nonqualified options/SARs outstanding with expiration dates ranging from September 15, 1986 to February 15, 1994. The average exercise price was $17.33, and such options/SARs were held by 22 participants.

The table on the following page summarizes the changes in options outstanding and related price ranges for shares of Common Stock under options:

	1985	1984	1983
Options:			
Outstanding at beginning of year	4,136,785	4,830,788	5,000,390
1982 Long-Term Incentive Plan:			
Granted	1,305,278	1,581,000	1,384,000
Exercised	(396,523)	(407,365)	(100,125)
1977 Stock Option Plan:			
Granted	459,114	—	—
Exercised	(403,415)	(891,038)	(935,330)
Career Executive Stock Plan:			
Granted	—	38,375	—
Exercised	(45,201)	(56,815)	(177,942)
Canceled and surrendered	(137,744)	(958,160)	(340,205)
Outstanding at end of year	4,918,294	4,136,785	4,830,788
Price Ranges:			
Outstanding at beginning of year	$11.51-26.30	$11.51-20.50	$ 8.69-20.50
Granted under 1982 Long-Term Incentive Plan	26.19-30.55	22.32-26.30	20.22
Granted under 1977 Stock Option Plan	27.50-31.55	—	—
Granted under Career Executive Stock Plan	—	23.45-26.30	—
Options/SARs exercised (market prices ranged from $25.25-34.88 in 1985, $21.12-28.78 in 1984 and $18.35-28.18 in 1983)	11.51-26.30	11.51-20.22	8.69-19.08
Canceled and surrendered	17.28-31.55	11.51-22.32	11.81-20.22
Outstanding at end of year	$11.81-31.55	$11.51-26.30	$11.51-20.50

At December 31, 1985, options were exercisable as to 2,373,437 shares, compared with 2,023,700 shares at December 31, 1984, and 2,321,780 shares at December 31, 1983. As of December 31, 1985, options for 8,323,123 shares of Common Stock were available for future grants.

Note 14
Cumulative Translation Adjustments

The changes in this account are shown in the following table:

	1985	1984
Balance at beginning of year	$(155)	$(103)
Translation and other adjustments	8	(67)
Related income taxes	7	2
Sale of energy operations (see Note 16)	—	13
Balance at end of year	$(140)	$(155)

Note 15
Retirement Benefits

The Company provides retirement benefits for substantially all of its regular full-time employees, including certain employees in foreign countries, through Company-sponsored plans and plans administered under collective bargaining agreements.

Pension expense for Company-sponsored plans in 1985, 1984 and 1983 was $81 million, $69 million and $93 million, respectively. The increase in 1985 was principally the result of the Nabisco Brands acquisition. The decrease in 1984 resulted primarily from two changes made during the year. The interest rate assumption used for funding purposes was changed to more accurately reflect anticipated investment performance. Also, the actuarial cost method was changed from entry age normal to projected unit credit, which more closely relates the expense to the period in which retirement benefits are earned. The Company's policy with respect to Company-sponsored plans is to fund pension costs accrued to the extent such costs are currently tax deductible. Past service costs are amortized over a 30-year period.

The following table presents information regarding the financial condition of the Company's domestic defined benefit plans, as estimated by the Company's consulting actuary, as of the most recent valuation dates, December 31, 1984 and 1983:

	Calculated using current salary levels of plan participants		Calculated using actuarial projections of future salary increases	
	1984	1983	1984	1983
Actuarial present value of accumulated plan benefits*:				
Vested	$1,331	$ 759	$1,619	$ 950
Non-vested	203	155	363	290
	$1,534	$ 914	$1,982	$1,240
Net assets available for benefits (market value)	$1,856	$1,179	$1,856	$1,179

*The assumed rate of return used in determining the actuarial present value of accumulated plan benefits in 1984 was 8½ percent and in 1983 was 8 percent.

The Company's foreign pension plans are not required to report to U.S. government agencies pursuant to ERISA and do not otherwise determine the actuarial value of accumulated benefits in the same manner as those calculated and disclosed above. For those plans, it is estimated that the value of vested benefits does not differ materially from the total assets and balance sheet accruals related to the plans.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Substantially all of its regular full-time employees, including certain employees in foreign countries, may become eligible for those benefits if they reach retirement age while working for the Company. The cost of retiree health care and life insurance benefits is recognized as expense when claims are paid, and amounted to $17 million in 1985 and $11 million in 1984. The increase in 1985 was principally the result of the Nabisco Brands acquisition.

Note 16
Discontinued Operations

On October 26, 1984, the Company sold its energy business for $1.7 billion in cash. The gain on the sale was $275 million after tax expense of $162 million, and added 98 cents to the 1984 net earnings per share.

On June 19, 1984, the Company divested its transportation operations through a pro rata distribution (spin-off) of all the common stock of Sea-Land Corporation to the holders of the Company's Common Stock. Prior to the distribution, Sea-Land paid the Company $400 million in settlement of intercompany balances and as a partial return of investment. The spin-off reduced "Common stockholders' equity" by $753 million, of which $213 million was allocated to "Paid-in capital" and $540 million to "Earnings retained."

Income from net interest charges on intercompany balances with discontinued operations is included in "Other income (expense), net." All balances were paid prior to the dispositions. For 1984 and 1983, the net interest income related to discontinued operations was $42 million and $31 million, respectively.

The summarized results of operations were as follows:

	1984	1983
Net sales and operating revenues	$1,987	$2,807
Earnings from operations	245	265
Earnings before provision for income taxes	208	255
Provision for income taxes	103	76
Spin-off expenses	13	—
Net earnings from discontinued operations	92	179

Responsibility for Financial Statements

R.J. Reynolds Industries, Inc. is responsible for the preparation and accuracy of the financial statements and other information included in this report. The financial statements have been prepared in accordance with generally accepted accounting principles using, where appropriate, management's best estimates and judgment.

The Company's independent auditors, Ernst & Whinney, have examined the financial statements in accordance with generally accepted auditing standards and their report appears herein.

In meeting its responsibility for the reliability of the financial statements, the Company depends on its system of internal accounting controls. The system is designed to provide reasonable assurance that assets are safeguarded and transactions are executed as authorized and properly recorded. The system is augmented by written policies and procedures and an extensive internal audit program.

The Board of Directors of the Company has an Audit Committee which is composed entirely of directors who are neither officers nor employees of the Company. The Audit Committee meets regularly with management, the internal auditors and the independent auditors to discuss audit scope and results and to address internal control and financial reporting matters. Both independent and internal auditors have unrestricted access to the Audit Committee.

J. Tylee Wilson

Chairman and Chief Executive Officer

Erwin H. Gillespie

Executive Vice President, Finance and Administration, and Chief Financial Officer

February 14, 1986

Report of Ernst & Whinney, Independent Auditors

R.J. Reynolds Industries, Inc.
Its Directors and Stockholders

We have examined the consolidated balance sheets of R.J. Reynolds Industries, Inc. and subsidiaries as of December 31, 1985 and 1984, and the related consolidated statements of earnings and earnings retained and changes in financial position for each of the three years in the period ended December 31, 1985. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of R.J. Reynolds Industries, Inc. and subsidiaries at December 31, 1985 and 1984, and the consolidated results of their operations and the changes in their consolidated financial position for each of the three years in the period ended December 31, 1985, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Whinney

Winston-Salem, North Carolina
February 14, 1986

Other Financial Data

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R.J. Reynolds Industries, Inc.

Lines of Business Data

The Company classifies its continuing operations into two principal lines of business which are described in Management's Discussion and Analysis, beginning on page 34 of this report. Summarized financial information for these operations for each of the past five years is shown in the following tables. Prior years' amounts have been reclassified to conform with the current year presentation. The 1985 amounts include the operations of Nabisco Brands, Inc. from July 2, 1985 (see Note 1 to the Financial Statements).

(Dollars in Millions)	**1985**	1984	1983	1982	1981
Net sales:					
Tobacco	**$ 8,062**	$ 7,845	$ 7,554	$ 6,804	$6,228
Food and beverage	**8,533**	5,129	4,758	3,356	2,471
Consolidated net sales	**$16,595**	$12,974	$12,312	$10,160	$8,699
Earnings from continuing operations:					
Tobacco	**$ 1,483**	$ 1,305	$ 1,152	$ 1,188	$1,109
Food and beverage	**763**	388	322	101	106
Corporate	**(83)**	(74)	(77)	(67)	(61)
Consolidated earnings from continuing operations	**$ 2,163**	$ 1,619	$ 1,397	$ 1,222	$1,154
Funds provided by continuing operations:					
Tobacco	**$ 1,060**	$ 906	$ 775	$ 762	$ 674
Food and beverage	**785**	410	372	137	147
Corporate	**(190)**	(34)	(40)	(124)	(32)
Consolidated funds provided by continuing operations	**$ 1,655**	$ 1,282	$ 1,107	$ 775	$ 789
Assets:					
Tobacco	**$ 4,496**	$ 3,812	$ 3,378	$ 3,219	$2,839
Food and beverage	**11,508**	3,883	3,293	3,506	1,775
Corporate*	**926**	1,577	1,097	665	748
	16,930	9,272	7,768	7,390	5,362
Net assets of discontinued operations	**—**	—	1,449	1,850	1,573
Consolidated assets	**$16,930**	$ 9,272	$ 9,217	$ 9,240	$6,935
Capital expenditures:					
Tobacco	**$ 647**	$ 527	$ 383	$ 238	$ 178
Food and beverage	**527**	257	210	123	96
Corporate	**20**	29	16	16	24
Consolidated capital expenditures	**$ 1,194**	$ 813	$ 609	$ 377	$ 298
Depreciation and amortization expense:					
Tobacco	**$ 146**	$ 107	$ 79	$ 81	$ 65
Food and beverage	**290**	149	130	77	45
Corporate	**13**	16	15	11	8
Consolidated depreciation and amortization expense	**$ 449**	$ 272	$ 224	$ 169	$ 118

*All cash and security investments are included in "Corporate" assets.

R.J. Reynolds Industries, Inc.

Geographic Data

The following table shows certain financial information relating to the Company's continuing operations in various geographic areas.

(Dollars in Millions)	1985	1984	1983	1982	1981
Net sales:					
United States	**$12,557**	$10,216	$ 9,584	$ 7,753	$6,541
Canada	**1,065**	628	566	548	516
Europe	**1,871**	1,336	1,383	1,146	1,044
Other geographic areas	**1,526**	1,194	1,117	1,038	888
Less transfers between geographic areas*	**(424)**	(400)	(338)	(325)	(290)
Consolidated net sales	$16,595	$12,974	$12,312	$10,160	$8,699
Earnings from continuing operations:					
United States	**$ 1,848**	$ 1,444	$ 1,283	$ 1,163	$1,137
Canada	**109**	53	44	44	35
Europe	**97**	46	37	32	(2)
Other geographic areas	**192**	150	110	50	45
Corporate	**(83)**	(74)	(77)	(67)	(61)
Consolidated earnings from continuing operations	$ 2,163	$ 1,619	$ 1,397	$ 1,222	$1,154
Assets:					
United States	**$11,657**	$ 6,191	$ 5,323	$ 5,493	$3,608
Canada	**1,048**	399	337	304	260
Europe	**1,598**	511	451	413	322
Other geographic areas	**1,701**	594	560	515	424
Corporate	**926**	1,577	1,097	665	748
	16,930	9,272	7,768	7,390	5,362
Net assets of discontinued operations	—	—	1,449	1,850	1,573
Consolidated assets	$16,930	$ 9,272	$ 9,217	$ 9,240	$6,935
Liabilities of the Company's continuing operations located in foreign countries	$ 905	$ 832	$ 844	$ 729	$ 681

*Transfers between geographic areas (which consist principally of fresh and canned fruit from Latin America, Africa and the Philippines transferred to the United States and Europe) are generally made at fair market value.

R.J. Reynolds Industries, Inc.

Inflation Accounting Data (Unaudited)

The current cost method adjusts certain historical amounts in the Consolidated Financial Statements for the changes in specific prices of property, plant and equipment, and inventory. This method involves the use of various assumptions and estimates; therefore, the results should not be viewed as a precise indicator of the effects of inflation.

The primary sources of data used to compute current cost are indices, direct pricing and engineering estimates. This information has been prepared using the "translate-restate" method for foreign operations.

Approximately 73 percent of the $197 million increase in "Costs and expenses" for 1985 is attributable to the increase in depreciation and amortization expense associated with the current cost increase in property, plant and equipment. The remaining portion of the increase is primarily attributable to the restatement of non-LIFO inventory costs to a current cost basis. Under the current cost method, the remaining statement of earnings items are considered to be at current cost and are not adjusted.

The "Unrealized purchasing power gain on net monetary position" shown below represents the preservation of purchasing power during the year through effective cash management. The Company has long recognized the potential effects of inflation and continually strives to reduce these effects on its businesses.

Consolidated Statement of Earnings from Continuing Operations Adjusted for the Effects of Changing Prices (Unaudited)

For the Year Ended December 31, 1985

(Dollars in Millions)	As Reported in the Financial Statements (Historical Cost)	Selected Data Adjusted for Changes in Specific Prices (Current Cost)
Net sales	$16,595	$16,595
Costs and expenses (1):		
Cost of products sold	10,127	10,304
Selling, advertising, administrative and general expenses	4,305	4,325
Earnings from continuing operations	2,163	1,966
Interest and debt expense	(356)	(356)
Other income (expense), net	47	47
Earnings from continuing operations before provision for income taxes	1,854	1,657
Provision for income taxes	853	853
Net earnings from continuing operations	$ 1,001	$ 804
Effective income tax rate	46.0%	51.5%
Unrealized purchasing power gain on net monetary position		$ 185
Increase in current cost of inventories and property, plant and equipment held during the year (based on specific price changes) (2)		$ 76
Effect of increase in general price level		362
Decrease in current cost of inventories and property, plant and equipment held during the year net of general inflation		$ (286)
Translation adjustments		$ 21

(1) The amount of depreciation and amortization expense related to items of property, plant and equipment for 1985 was $333 million on a historical cost basis and $477 million on a current cost basis.

(2) At December 31, 1985, current cost of inventory was $4.6 billion (historical amount $3.2 billion) and current cost of property, plant and equipment, net of depreciation, was $7.3 billion (historical amount $5.5 billion).

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for the Effects of Changing Prices (Unaudited)

For the Years Ended December 31

(Dollars in Millions Except Per Share Amounts)	1985	1984	1983	1982	1981
In Average 1985 Dollars:					
Net sales	**$16,595**	$13,437	$13,294	$11,323	$10,289
Current cost information:					
Net earnings from continuing operations	**804**	713	600	484	502
Net earnings from continuing operations per common share	**2.82**	2.33	1.89	1.66	1.77
Increase (decrease) in current cost of inventories and property, plant and equipment held during the year net of general inflation	**(286)**	27	(39)	62	(9)
Net assets related to continuing operations at year end	**9,600**	8,040	7,551	6,775	5,969
Translation adjustments	**21**	(63)	(65)	(40)	—
Other information:					
Unrealized purchasing power gain on net monetary position	**185**	62	79	68	118
Cash dividends per common share	**1.41**	1.35	1.32	1.27	1.19
Market price per common share at year end	**$ 30⅞**	$ 29⅜	$ 25¾	$ 22½	$ 21⅝
Average consumer price index	**322.2**	311.1	298.4	289.1	272.4

R.J. Reynolds Industries, Inc.

Quarterly Results of Operations (Unaudited)

The following is a summary of the quarterly results of operations for the years ended December 31:

(Dollars in Millions Except Per Share Amounts)	First	Second	Third	Fourth (2)
1985 (1)				
Net sales	**$2,898**	**$3,404**	**$4,764**	**$5,529**
Earnings from continuing operations	**354**	**452**	**618**	**739**
Net earnings from continuing operations	**182**	**228**	**257**	**334**
Net earnings	**182**	**228**	**257**	**334**
Net earnings from continuing operations per common share	**0.66**	**0.86**	**0.91**	**1.17**
Net earnings per common share	**0.66**	**0.86**	**0.91**	**1.17**
1984				
Net sales	$2,855	$3,363	$3,224	$3,532
Earnings from continuing operations	314	400	414	491
Net earnings from continuing operations	151	204	229	259
Net earnings	166	266	253	525
Net earnings from continuing operations per common share	0.48	0.67	0.76	0.89
Net earnings per common share	0.53	0.89	0.84	1.85

Previously published quarterly financial data have been restated to reflect the Company's 1985 two and one-half for one Common Stock split (see Note 13 to the Financial Statements).

(1) The 1985 results of operations include the operations of Nabisco Brands, Inc. from July 2, 1985 (see Note 1 to the Financial Statements).

(2) In the fourth quarter of 1984, the Company sold its energy operations. The net gain from the sale added $275 million to fourth quarter net earnings, or 98 cents per share (see Note 16 to the Financial Statements).

R.J. Reynolds Industries, Inc.

Board of Directors

William S. Anderson
Chairman, Executive Committee
NCR Corporation
(manufacturer of business equipment)
- Audit Committee
- Finance Committee
- Organization and Compensation Committee

Albert L. Butler, Jr.
President
The Arista Company (real estate holding and management company)
- Executive Committee
- Finance Committee
- Nominating Committee
- Organization and Compensation Committee (Chairman)

John L. Clendenin
Chairman and Chief Executive Officer
BellSouth Corporation
(telecommunications holding company)
- Audit Committee
- Organization and Compensation Committee

Gwain H. Gillespie
Executive Vice President, Finance and Administration, and Chief Financial Officer
R.J. Reynolds Industries, Inc.
- Executive Committee
- Finance Committee
- (Chairman)

Ronald H. Grierson
Vice Chairman
General Electric Company PLC
(manufacturer of electrical products - England)
- Audit Committee
- Finance Committee

John W. Hanley
Chairman of the Executive Committee
Monsanto Company
(multinational diversified chemical company)
- Organization and Compensation Committee
- Public Policy Committee

Edward A. Horrigan, Jr.
Vice Chairman of the Board
R.J. Reynolds Industries, Inc.
- Executive Committee
- Finance Committee
- Public Policy Committee

Charles E. Hugel
President and Chief Executive Officer
Combustion Engineering, Inc.
(supplier of energy-related products and services)
- Audit Committee

F. Ross Johnson
President and Chief Operating Officer
R.J. Reynolds Industries, Inc.
- Executive Committee
- Finance Committee
- Nominating Committee

Vernon E. Jordan, Jr.
Partner
Akin, Gump, Strauss, Hauer & Feld (Washington, D.C., law firm)
- Nominating Committee
- Organization and Compensation Committee
- Public Policy Committee

Juanita M. Kreps
Former United States Secretary of Commerce
- Audit Committee
- Executive Committee
- Public Policy Committee

Gerald H. Long
President and Chief Executive Officer
R.J. Reynolds Tobacco Company

John D. Macomber
Chairman and Chief Executive Officer
Celanese Corporation
(diversified chemical company)
- Finance Committee
- Nominating Committee (Chairman)
- Organization and Compensation Committee

John G. Medlin, Jr.
President and Chief Executive Officer
First Wachovia Corporation
(bank holding company)
- Audit Committee (Chairman)
- Executive Committee
- Finance Committee

Andrew G. C. Sage II
Managing Director
Shearson Lehman Brothers, Inc.
(investment banking services company)
- Organization and Compensation Committee

Robert M. Schaeberle
Chairman of the Board and Chairman, Executive Committee
Nabisco Brands, Inc.
- Public Policy Committee

J. Paul Sticht
Retired Chairman of the Board
R.J. Reynolds Industries, Inc.
- Executive Committee (Chairman)
- Finance Committee
- Nominating Committee
- Organization and Compensation Committee
- Public Policy Committee (Chairman)

Stuart D. Watson
Consultant and Former Chairman
Heublein Inc.
- Audit Committee
- Public Policy Committee

James O. Welch, Jr.
President and Chief Executive Officer
Nabisco Brands, Inc.

J. Tylee Wilson
Chairman and Chief Executive Officer
R.J. Reynolds Industries, Inc.
- Executive Committee
- Finance Committee
- Nominating Committee

R.J. Reynolds Industries, Inc.

Shareholder Information

Corporate Headquarters
RJR World Headquarters
Reynolds Boulevard
Winston-Salem,
North Carolina 27102
Telephone: 919-773-2000

Shareholder Inquiries
Communications concerning transfer requirements and lost certificates should be directed to either Transfer Agent. Communications concerning dividends and change of address should be directed to R.J. Reynolds Industries, Inc., Shareholder Services Department, P.O. Box 2959, Winston-Salem, North Carolina 27102.
Telephone: 919-773-2349

Transfer Agents and Registrars
Manufacturers Hanover Trust Company
Corporate Trust Division
450 West 33rd Street
New York, New York 10001

The First Jersey National Bank
2 Montgomery Street
Jersey City, New Jersey 07303

Independent Auditors
Ernst & Whinney
153 East 53rd Street
New York, New York 10022

Suite 2000
Wachovia Building
Winston-Salem,
North Carolina 27111

Common Shares
Listed on the New York, London, Zurich, Geneva, Basel, Amsterdam, Frankfurt, West Berlin, Dusseldorf, Paris, Brussels and Antwerp stock exchanges.

Trading symbol on New York Stock Exchange: RJR.

Dividend Reinvestment Plan
All registered holders of R.J. Reynolds Industries Common Stock are eligible to participate in a convenient and economical method for automatically reinvesting their dividends toward the purchase of additional shares of the company's Common Stock.

The Plan offers:

- prompt reinvestment of dividends;
- optional cash deposits for direct purchase of additional shares;
- all service fees and broker commissions company-paid.

A booklet describing the Plan, together with an enrollment card, can be obtained by writing the Shareholder Services Department, P.O. Box 2959, Winston-Salem, North Carolina 27102, or calling 919-773-2356.

Notice of Annual Meeting
The Annual Meeting of the company's shareholders will be held at the Hotel du Pont, 11th and Market Streets, Wilmington, Delaware, at 2 p.m. on Wednesday, April 23, 1986. A formal notice of the Annual Meeting, together with Proxy Statement and Proxy, will be mailed in March to shareholders of record at the close of business February 24, 1986.

Availability of Form 10-K
On or after March 31, 1986, a copy of the company's Annual Report to the Securities and Exchange Commission on Form 10-K for the year ended December 31, 1985, will be provided to shareholders upon written request to: Manager, Shareholder Services Department, R.J. Reynolds Industries, Inc., P.O. Box 2959, Winston-Salem, North Carolina 27102.

Supplemental Information
R.J. Reynolds Industries periodically publishes material supplementing the information found in annual and quarterly reports. Shareholders and other interested investors may write to request reprints of financial community presentations, corporate responsibility information and speeches delivered by senior management. Requests should be directed to Financial Public Relations, R.J. Reynolds Industries, Inc., Reynolds Boulevard, Winston-Salem, North Carolina 27102.
Telephone: 919-773-4604

Security analysts and other investment professionals should direct their inquiries to Henry R. Lambert, Vice President, Investor Relations, R.J. Reynolds Industries, Inc., Reynolds Boulevard, Winston-Salem, North Carolina 27102.
Telephone: 919-773-2624

JOSE
CUERVO
La Rojeña
Tequila

Shreddies

IMPORTED
LANCERS
Rose Wine

Mo

Menthol Fresh
Salem

PLANTERS
Cocktail
PEANUTS

QUALITÉ
Del Monte
HARICOTS VERTS
COUPÉS

LIFE SAVERS
LIFE SAVERS